IN THE MATTER OF AN ARBITRATION UNDER CHAPTER ELEVEN OF THE NORTH AMERICAN FREE TRADE AGREEMENT AND THE ICSID ARBITRATION (ADDITIONAL FACILITY) RULES

BETWEEN:

MOBIL INVESTMENTS CANADA INC. AND MURPHY OIL CORPORATION

Claimants/Investors

AND:

GOVERNMENT OF CANADA

Respondent/Party

GOVERNMENT OF CANADA

COUNTER MEMORIAL

1 December 2009

Departments of Justice and of
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TABLE OF ABBREVIATIONS

BIT	Bilateral Investment Treaty
CAPP	Canadian Association of Petroleum Producers
CRA	Canada Revenue Agency
CUSFTA	Canada-United States Free Trade Agreement
E&T	Education and Training
FET	Fair and Equitable Treatment
FTC	Free Trade Commission
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
HCOM	Host Country Operational Measures
HMDC	Hibernia Management and Development Company Ltd.
MAI	Multilateral Agreement on Investment
MNC	Multinational Corporation
MUN	Memorial University of Newfoundland
NAFTA	North American Free Trade Agreement
NL	Newfoundland and Labrador
OECD	Organization for Economic Co-operation and Development
POA	Production Operation Authorization
R&D	Research and Development
SR&ED	Scientific Research and Experimental Development
TRIMS	Agreement on Trade Related Investment Measures

UNCTAD	United Nations Conference on Trade & Development
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

I. INTRODUCTION

1. When oil was discovered off its coast in the late 1970s, unemployment in the province of Newfoundland and Labrador ("NL") was close to 15% and Gross Domestic Product ("GDP") per capita was barely half of the Canadian average. The Government of NL immediately recognized the importance of using any wealth generated by the oil to promote the sustainable development of the province. In particular, the Government realized that development would only be sustainable if skills and knowledge were acquired which could be relied on after oil reserves were exhausted.

2. Consequently, in exchange for the exclusive right to exploit marine oil reserves off its coast, the Government of NL required companies to contribute to the sustainable development of the province. The Accord Acts, which describe the rules for the extraction of oil off the coast of NL, require companies to provide benefits to the province and Canada. One of those benefits is expenditures on research and development ("R&D") and education and training ("E&T") in NL. According to section 45(3)(c) of the Acts, "expenditures shall be made for research and development to be carried out in the Province and for education and training to be provided in the Province."

3. The Accord Acts created the Canada-Newfoundland Offshore Petroleum Board ("Board") to regulate the extraction of oil off the coast of NL and to oversee compliance with the Acts' requirements. To ensure that the operators fulfilled their obligation under section 45(3)(c) to expend on R&D and E&T in NL, the Board required them to report those expenditures.

4. The Board was initially satisfied with reported expenditures for Hibernia and Terra Nova. However, in 2001, the operators reported declining expenditures on R&D and E&T. Concerned that the operators would not fulfil their obligation under the Accord Acts, the Board immediately explained that it expected expenditures consistent with average expenditures on R&D by oil extracting companies in Canada. The Board also indicated it would subsequently clarify its expectations through guidelines.

5. These Guidelines for Research and Development Expenditures ("Guidelines") were issued in 2004.[1] The Guidelines explain:

> R&D [and E&T] represent one avenue whereby the exploration for, and the development and production of the petroleum resources in the Newfoundland Offshore area can make a contribution to the sustainable development of the Province. This was the vision or intent of the legislators at the time when they inserted the requirement for R&D and E&T 'in the Province' into the Atlantic Accord legislation. The petroleum resource is finite and exhaustible, and it is the intent of this provision of the legislation that its exploitation create a lasting economic legacy for the people of the Province. This is best achieved by building on the intellectual capacity and human resources of the Province. Achievement of this legislative intent is a key reason why some parameters or guidance are required in respect of the requirement in the Act that there be expenditures in the Province for R&D. These guidelines seek to establish such parameters.

6. The Claimants immediately challenged the Guidelines in Canada. Three levels of Canadian courts rejected the challenge, holding that the Board acted under the authority of, and consistent with, the provisions of the Accord Acts which ensure expenditures on R&D and E&T in NL. The NL Court of Appeal concluded that the Board:

> approved the ... projects on condition that the Board have the authority to continuously monitor research and development expenditures and intervene by issuing guidelines requiring higher expenditures should the appellants' level of expenditures fall below that which the Board considered appropriate. These were the rules of the game when development approvals [sic.] issued. The same rules apply today.[2]

7. After failing before three Canadian courts, the Claimants now challenge the Guidelines again. The Claimants seek, once again, to avoid their obligation to expend on R&D and E&T in NL and break "the rules of the game."

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[1] **CE-1**, CNLOPB, Guidelines for Research and Development Expenditures (Oct. 2004) p. 1 (hereinafter "Guidelines").

[2] **CA-53**, Court of Appeal Decision, Justice Barry, ¶ 135.

8. The Claimants allege that the Guidelines are a performance requirement which breaches Article 1106(1)(c) of the North American Free Trade Agreement ("NAFTA"). However, Article 1106 only proscribes an exhaustive list of performance requirements which does not include requirements for local R&D and E&T.

9. Even if requirements for R&D and E&T do fall within the scope of Article 1106, the Guidelines do not breach the Article. To violate Article 1106(1)(c), a NAFTA party must compel the purchase, use or accordance of a preference to local goods or services. However, the Guidelines contain no such compulsion. The Claimants can fulfil their obligations under the Guidelines without purchasing, using or according a preference for local goods or services.

10. Even if the Guidelines are inconsistent with Article 1106(1)(c), the Guidelines do not breach the Article because they fall within the reservation for the Accord Acts. To preserve its ability to ensure that NL's oil resources were used to promote the sustainable development of the province, Canada reserved the Accord Acts from the scope of Article 1106. The NAFTA provides that a reserved measure also includes subordinate measures. Consequently, measures subordinate to the Accord Acts fall within Canada's reservation from Article 1106.

11. Under the definition of "subordinate measure" in the NAFTA, the Guidelines are subordinate to the Accord Acts if they were adopted under the authority of, and are consistent with, those Acts. The Guidelines meet this definition. The Accord Acts require expenditures on R&D and E&T in NL. The Acts also give the Board the authority to issue guidelines "with respect to the application and administration of" this requirement. By exercising this authority when it issued the Guidelines, the Board acted under the authority of, and consistently with, the Accord Acts. This conclusion was confirmed by the decisions of Canadian courts. Consequently, the Guidelines are subordinate to the Accord Acts and are reserved from Article 1106.

12. The Claimants also allege that the Guidelines breach Article 1105 by frustrating their legitimate expectations and altering the regulatory framework under which their

investment was made. This claim is without merit. The Claimants have failed to establish that changes in the regulatory framework and failure to meet legitimate expectations of investors amount to a breach of the customary international law minimum standard of treatment required by Article 1105. Even if the Claimants had proven that these obligations were part of customary international law, the Guidelines do not frustrate the Claimants' legitimate expectations. Nor has Canada failed to provide a stable regulatory framework for the Claimants' investment. The decisions of the Canadian courts provide ample evidence to the contrary and confirm that the Board acted within its regulatory authority and consistent with the original intent and understanding of the Accord Acts.

II. THE FACTS

A. The Discovery of Oil Provides an Opportunity for Sustainable Development in Newfoundland and Labrador

13. In the late 1970s, unemployment in NL was 15%, nearly double the national rate.[3] GDP per capita was barely half the national average[4] and the province relied on Federal Government transfers for nearly half of its revenue.[5]

14. The opportunity to address unemployment in NL and provide for the long-term future of the province arose with the discovery of oil. The Government of NL quickly recognized that the resource could be used to promote the sustainable development of NL, but only if it was used properly. The Government realized that any development resulting from the oil would only be sustainable if the oil was used to develop skills and expertise in NL. For example, in 1977, the Government recognized that:

> if we do not prepare ourselves from a technological point of view and if we, in this province, are not in the forefront of the development of the skills and expertise needed to develop the province's offshore oil and gas resources then our benefit will be commensurately smaller.[6]

15. The Government of NL believed these skills and expertise could be best developed by ensuring that oil companies perform R&D and E&T in the province. The Government stated that "[i]t is imperative that the Province become involved in this new industry at the highest possible technical level, thus the provision for compulsory

[3] **RE-42**, Statistics Canada, Labour Force Survey, Labour Force Historical Review (1976-2008).

[4] **RE-41**, Statistics Canada, GDP - Provincial Economic Accounts, Population – Demography Division: "GDP at Market Prices NL and Canada and Population NL and Canada" (1971-2008).

[5] **RE-8**, Statistics Canada, Provincial Economic Accounts, No. 13-213 Annual (1987), p. 62.

[6] **RE-5**, A Consultative Document on Petroleum Related Education & Training and Research and Development Programs under the Newfoundland and Labrador Petroleum Regulations, 1977, issued under the authority of A. Brian Peckford, Minister of Mines and Energy, p. 1 (Nov. 9, 1977).

education and training and research and development expenditures in the Province."[7] Consequently, in the subsequent *Newfoundland and Labrador Petroleum Regulations* of 1977, the Province required oil companies applying for a permit or lease to expend a certain amount on R&D and E&T in NL.[8]

16. In 1985, the Government of NL established a task force to advise on how best to ensure economic development from increased R&D in the province. The Terms of Reference for the task force noted:

> the desire of the Province of Newfoundland that offshore oil and gas resources be developed in a manner which will facilitate long term economic prosperity and social enhancement. One element deemed crucial to ensuring that long term prosperity is establishment of strategic (i.e. marine) 'Centres of Excellence' with a strong technological/scientific orientation. A strong research and development base with a bias toward development is fundamental to the establishment and maintenance of these 'Centres of Excellence.'[9]

17. To reach these goals, the task force advised that:

> We should be very aware of the context of existing R & D support programs and how we can work to complement the efforts of researchers (both within and outside the Province), so that their current funding can be supplemented and made more productive. Given the expertise which can be developed in the context of studying a specific local problem, we would then have a good opportunity to develop the kind of "world class" levels of analytical capability and general expertise which are saleable in export markets...Our task, first and foremost, is to become a significant contributor of technology on our own continental shelf and in northern and arctic waters generally...The strength of the

[7] **RE-4**, A White Paper Respecting the Administration and Disposition of Petroleum Belonging to Her Majesty in Right of the Province of Newfoundland, Issued under the Authority of A. Brian Peckford, Minister of Mines and Energy (May, 1977) p. 47.

[8] **RA-39**, *Newfoundland and Labrador Petroleum Regulations*, Nfld., Reg. 233/77, s. 120(1).

[9] **RE-7**, Report of the Task Force on Oil-Related Research and Development to the Honourable Hal Barrett, Minister of Development and Tourism, Attachment A (Dec. 23, 1985).

> existing R&D base in Newfoundland, as elsewhere, lies first, in its human resources and, second, in its physical plants; in both respects, we have an excellent foundation on which to build.[10]

18. The task force concluded that NL had "an excellent chance of becoming a major world centre of excellence in marine-related research and development with all the potential for economic growth and spin-off industries implicit in such world class capability."[11] According to the task force, a "tremendous opportunity awaits us – with hard work and adequate funding, marine-related education and research can make a very substantial contribution in improving the economic and social life of Newfoundland and Labrador."[12]

19. To ensure that it could use the oil off its coast to promote sustainable development in the province, the Government of NL fought for control over the oil with the Federal Government.[13] Despite a ruling of the Supreme Court of Canada giving the Federal Government legislative jurisdiction over the continental shelf off the coast of NL, including the oil under that shelf, the Government of the province continued to fight to be the principal beneficiary of the oil.[14]

20. The dispute between the federal and provincial governments was resolved in 1985 by the Memorandum of Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing with the Federal Government.[15] This agreement, better known as the

[10] *Id.*, p. 6, emphasis in original.

[11] *Id.*, p. 24.

[12] *Id.*, p. 26.

[13] As explained by John Fitzgerald, who was the Deputy Minister of the province's Petroleum Directorate at the time, "[t]he federal authorities took the position that the benefits should accrue to Canada generally while the provincial government insisted that Newfoundland should be the principal beneficiary." First Witness Statement of John Fitzgerald, ¶ 26 (hereinafter "Fitzgerald Statement").

[14] Fitzgerald Statement, ¶ 25.

[15] **CA-10**, The Atlantic Accord: A Memorandum of Agreement Between the Government of Canada and the Government of Newfoundland and Labrador on Offshore Oil and Gas Resource Management and Revenue Sharing (Feb. 11, 1985) (hereinafter "Accord").

"Canada-Newfoundland Atlantic Accord," "Atlantic Accord," or "the Accord," formalized an understanding between the federal and provincial governments regarding the joint management of petroleum resources off the coast of Newfoundland. The Accord "recognize[d] the right of Newfoundland and Labrador to be the principal beneficiary of the oil and gas resources off its shores ...".[16] The Accord also stated that "[i]t is the objective of both governments to ensure that the offshore area is managed in a manner which will promote economic growth and development in order to optimize benefits accruing to Newfoundland in particular and to Canada as a whole."[17]

21. To optimize these benefits to NL and the country, the Accord provided that operators of offshore oil projects would be required to submit a plan explaining the process by which benefits would accrue to the Province and Canada.[18] The Accord provided that such "Benefits Plans" would provide "that first consideration is given to services provided from within Newfoundland, and to goods manufactured in Newfoundland, where such goods and services are competitive in terms of fair market price, quality, and delivery."[19] The Accord also stated that "[b]enefits plans ... shall provide for expenditures to be made on research and development, and education and training, to be conducted within the province."[20]

22. These benefits plans, under which operators must provide for expenditures to be made on R&D and E&T, are to be approved by the Canada-Newfoundland Offshore Petroleum Board.[21] The Accord created the Board to administer the legislation that was being drafted to regulate the extraction of oil off the coast of NL[22] and make "decisions

[16] *Id.*, s. 2(c).

[17] *Id.*, s. 50.

[18] *Id.*, s. 51.

[19] *Id.*, s. 51.

[20] *Id.*, s. 55.

[21] *Id.*, s. 51.

[22] *Id.*, s. 3.

relating to the regulation and management of petroleum-related activities in the offshore area."[23] The Board consists of seven members, appointed by the federal and provincial governments.[24]

23. The Board was not only given the authority by the Accord to approve *Benefits Plans* which ensured expenditures on R&D and E&T in the province, the Board was also given the authority to approve the *actual expenditures*. The Accord provides that "[e]xpenditures made by companies active in the offshore pursuant to this requirement *shall be approved by the Board.*"[25]

B. The Accord Acts Promote Sustainable Development in the Province through Expenditures on R&D and E&T

1. The Accord Acts Require Benefits Plans Which Ensure Expenditures on R&D and E&T in the Province

24. The Accord was implemented through parallel legislation by the federal and provincial governments: the Canada-Newfoundland Atlantic Accord Implementation Act and the Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act,[26] commonly known as the "Accord Acts."

25. Consistent with the Accord, the Accord Acts were drafted to ensure that the extraction of oil resources provides local benefits, including the development of skills and knowledge. The Acts also require that oil project operators have Benefits Plans

[23] *Id.*, s. 24.

[24] *Id.*, s. 4.

[25] *Id.*, s. 55, emphasis added. When referring to section 55 of the Accord, Justice Barry of the NL Court of Appeal stated that "the Accord expressly and clearly provides that expenditures made by companies on research and development shall be approved by the Board." **CA-53**, Court of Appeal Decision, ¶ 120, Justice Barry.

[26] **CA-11**, Canada-Newfoundland Atlantic Accord Implementation Act, 1987, c. 3 (hereinafter "Federal Accord Act"); **CA-12**, Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act, R.S.N.L. 1990, c. C-2 (hereinafter "Provincial Accord Act"). This Counter Memorial refers to these two Acts collectively as the "Accord Acts." References to sections are references to sections in the Federal Accord Act.

approved by the Board, which must ensure benefits for NL, including R&D and E&T expenditures. Section 45 of the Act states:

> 1) In this section, "Canada-Newfoundland Benefits Plan" means a plan for the employment of Canadians and, in particular, members of the labour force of the Province and, subject to paragraph (3)(d), for providing manufacturers, consultants, contractors and service companies in the Province and other parts of Canada with a full and fair opportunity to participate on a competitive basis in the supply of goods and services used in any proposed work or activity referred to in the Benefits Plan.
>
> 2) Before the Board may approve any Development Plan pursuant to subsection 139(4) or authorize any work or activity under paragraph 138(1)(b), a *Canada-Newfoundland Benefits Plan shall be submitted to and approved by the Board*, unless the Board directs that that requirement need not be complied with.
>
> 3) *A Canada-Newfoundland Benefits Plan shall contain provisions intended to ensure that*:
>
> (a) before carrying out any work or activity in the offshore area, the corporation or other body submitting the plan shall establish in the Province an office where appropriate levels of decision-making are to take place;
> (b) consistent with the Canadian Charter of Rights and Freedoms, individuals resident in the Province shall be given first consideration for training and employment in the work program for which the plan was submitted and any collective agreement entered into by the corporation or other body submitting the plan and an organization of employees respecting terms and conditions of employment in the offshore area shall contain provisions consistent with this paragraph;
> (c) *expenditures shall be made for research and development to be carried out in the Province and for education and training to be provided in the Province*; and
> (d) first consideration shall be given to services provided from within the Province and to goods manufactured in the Province, where those services and goods are competitive in terms of fair market price, quality and delivery.[27]

26. As held by Canadian courts:

[27] Emphasis added.

> [S]ection 45(3) of the federal Act provides that a Canada-Newfoundland benefits plan *shall* contain provisions intended to ensure that expenditures shall be made for research and development to be carried out in the Province. These mandatory provisions contain no qualification entitling oil companies to refuse to expend on research and development because they are of the opinion the needs of their projects can be met with existing knowledge and technology.[28]

27. The Claimants ignore both section 45(3)(c) and the decision of Canadian courts when they argue that they have "never had any R&D spending obligation" prior to the Guidelines.[29] They also ignore the expenditure requirement in section 45(3)(c) when they discuss the "typical" R&D and E&T expenditures of oil companies who are not subject to specific legal requirements[30] or the expenditures "necessary" for their projects.[31] Regardless of "typical" or "necessary" R&D and E&T expenditures, the Claimants' operations in NL are governed by the Accord Acts, and those Acts state that expenditures "shall be made" in the province.

28. The importance of this requirement is reinforced by the expert report of David Montgomery submitted by the Claimants. Mr. Montgomery argues that typical oil companies, particularly those in joint ventures, do not have an incentive to conduct R&D through the life of their projects.[32] Thus, market forces alone are not enough to ensure sustainable development in NL from the extraction of finite oil resources; hence, provisions like section 45(3)(c) are necessary.

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[28] **CA-53**, Court of Appeal Decision, ¶ 130, per Justice Barry, emphasis in original.

[29] First Witness Statement of Paul Phelan, ¶ 10 (hereinafter "Phelan Statement").

[30] Claimants' Memorial, ¶¶ 36-37, 48; Expert Report of David Montgomery (hereinafter "Montgomery Report").

[31] Claimants' Memorial, ¶ 72.

[32] Montgomery Report, ¶¶ 28-29.

2. The Accord Acts Give the Board Authority to Issue Guidelines Concerning the Application of the R&D and E&T Requirement

29. The Accord Acts give the Board the authority to issue guidelines with respect to the application of the R&D and E&T requirement of section 45(3)(c). Section 151.1(1) of the Act states that "[t]he Board may issue and publish, in such manner as the Board deems appropriate, guidelines and interpretation notes with respect to the application and administration of sections 45, 138 and 139 or any regulations made under section 149."[33]

30. The Board has exercised this authority to issue guidelines with respect to the application and administration of sections of the Accord Acts to issue over twenty guidelines.[34] For example, the Board issued the *Offshore Waste Treatment Guidelines* to describe standards which it will apply "in making decisions related to waste treatment, disposal and monitoring."[35] Similarly, the Board issued the *Safety Plans Guidelines* to clarify the content of required safety plans for each project.[36] As explained by the current Vice-Chair of the Board, Frederick Way, guidelines are an "integral part of how the

[33] **CA-11**, Federal Accord Act.

[34] **RE-46,** CNLOPB, Legislation and Guidance: Drilling Programs; Joint Guidelines Regarding Applications for Significant or Commercial Discovery Declarations (May 2003); Research and Development Expenditure Guidelines (Oct. 2004); Development Plan Guidelines (Feb. 2006); Offshore Physical Environmental Guidelines (Sep. 2008); Guidelines Respecting Monthly Production Reporting for Producing Fields (Sep. 2001); Newfoundland and Labrador Offshore Area Registration System Guidelines (Jan. 1994); Offshore Chemical Selection Guidelines for Drilling & Production Activities on Frontier Lands (Apr. 2009); Transboundary Crewing Guidance; Exploration Benefits Plan Guidance; Guidelines for the Reporting and Investigation of Incidents (Jun. 2009); Benefits Plan Guidelines (Feb. 2006); Compensation Guidelines Respecting Damages Relating to Offshore Petroleum Activity (Mar. 2002); Guidelines Respecting Financial Responsibility Requirements for Work or Activity Offshore (Dec. 2000); Guidance Respecting Reporting Lift Gas Volumes (Jun. 2005); Measurement Guidelines Under Production and Conservation Regulations (Oct. 2003); Geophysical, Geological, Environmental and Geotechnical Programs (Jan. 1999); Draft Certificate of Fitness Guidelines (Oct. 2001); Safety Plan Guidelines; Offshore Waste Treatment Guidelines (Aug. 2002); Monitoring and Reporting Guidance; Guidelines for Drilling Equipment; and Joint Guidelines Respecting Data Acquisition and Reporting for Well, Pool and Field Evaluations in the Newfoundland and Nova Scotia Offshore Areas (Jun. 2003). Also available online at: http://www.cnlopb.nl.ca/leg_guidelines.shtml.

[35] **RE-25**, CNLOPB, Offshore Waste Treatment Guidelines (Aug. 2002), p. 1.

[36] **RE-1**, CNLOPB, Safety Plan Guidelines.

Board exercises its authority and the Board is constantly developing and reviewing them."[37] He also notes that:

> Guidelines provide specific direction where the Board has been given the authority to prescribe and guidance where the Board may approve certain activities. Further, Guidelines provide direction on how the Board interprets the broadly based legislative requirements governing the offshore area.[38]

3. The Accord Acts Give the Board Authority to Link Production Operation Authorizations to Compliance with Guidelines

31. The Accord Acts provide that "[t]he Board shall perform such duties and functions as are conferred or imposed on the Board by or pursuant to the Atlantic Accord or this Act."[39] These duties or functions include the authorization and approval of all projects for the extraction of oil off the coast of NL.[40] The Board performs this duty or function by issuing Production Operation Authorizations, or POAs. Each production project must have a valid POA. POAs are issued for a specific period of time and on expiry a new POA must be approved. The length of a POA is at the Board's discretion, but is typically three to five years, as recognized by the Claimants.[41]

32. The current Vice-Chairman of the Board, Frederick Way, explains that:

> The Board's ability to regulate offshore production operations effectively is through its ability to suspend, revoke or refuse to renew the POA. An operator cannot produce petroleum without a POA. The mandate of the Board includes overseeing and ensuring operator compliance with statutory provisions including provisions for...Canada / Newfoundland and Labrador benefits.[42]

[37] First Witness Statement of Frederick Way, ¶ 30 (hereinafter "Way Statement").

[38] Way Statement, ¶ 35.

[39] **CA-11**; Federal Accord Act, s. 17.

[40] **CA-11**, Federal Accord Act, s. 138.

[41] Claimants' Memorial, ¶ 44.

[42] Way Statement, ¶ 23.

33. The Accord Acts give the Board wide discretion in the approval of POAs, stating that "[a]n authorization is subject to such approvals as the Board determines, or as may be granted in accordance with the regulations and such requirements and deposits as the Board determines, or as may be prescribed."[43] The Board has subsequently used this discretion to link its issuance of a POA with the operator's compliance with guidelines. For example, in order to receive a POA, operators must comply with the *Guidelines Respecting Financial Responsibility* and the *Offshore Waste Treatment Guidelines*.[44] Prior to challenging the Guidelines before Canadian courts,[45] the Claimants never questioned the authority of the Board to condition the issuance of a POA on compliance with guidelines.

34. If an operator is not complying with its obligations the Board can refuse to renew the POA. For example, in 2004 the Board refused to renew the POA for the Terra Nova project because the operator failed to fulfil its obligation to ensure safety by properly maintaining equipment.[46]

35. Consequently, the Board has the authority to refuse to renew a POA if the operator is not fulfilling their obligation to expend on R&D and E&T.

C. The Decision Approving the Hibernia Benefits Plan Ensured Expenditures on R&D and E&T

36. Shortly after the signature of the Accord, in September 1985, the operators of the Hibernia project submitted their Benefits Plan to the Board for its approval.[47]

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[43] **CA-11**, Federal Accord Act, s. 138(4).

[44] **RE-21**, Guidelines Respecting Financial Responsibility Requirements for Work or Activity Offshore (Dec. 2000); **RE-25**, Offshore Waste Treatment Guidelines.

[45] Counter Memorial, ¶¶ 131-141.

[46] Way Statement, ¶ 25.

[47] **CE-45**, Mobil Oil Canada, Hibernia Canada/Newfoundland Benefits Plan (Sept. 15, 1985) (hereinafter "Hibernia Benefits Plan").

37. Before the Board issued its decision, the Hibernia Environmental Assessment Panel submitted its report. The Panel was struck by the federal and provincial governments to consult with the public and examine the environmental, socio-economic and safety impacts of the Hibernia project. The Environmental Assessment Panel recommended that the operators undertake R&D in specific areas.[48] Furthermore, the Panel recommended that the implementation of the operators' plan to provide local benefits, including R&D and E&T expenditures, "should be closely monitored throughout its life."[49]

38. Shortly after the report of the Environmental Assessment Panel was issued, the Board released *Guidelines for Benefits Plan Approval and Reporting Requirements for Exploration Activities in the Newfoundland Offshore Area* ("1986 Exploration Phase Guidelines").[50] Given that oil companies were still only exploring for oil off the coast of NL, the guidelines only addressed the exploration phase. They did not contain guidelines concerning the subsequent development and production phases.[51]

39. The 1986 Exploration Phase Guidelines described what oil companies needed to include in their Benefits Plan, including "proposed expenditures and activities on research and development [and education and training] to be carried out within the Province."[52] The guidelines also required operators to submit annual reports describing

[48] **RE-6**, Report of the Environmental Assessment Panel, Hibernia Development Project (Dec. 1985), recommendation 24, p. 46 ("Research and development to improve the ability to detect and manage ice under adverse weather conditions should be undertaken;") and recommendation 30, p. 47 ("... special emphasis should be placed on prevention of offshore spills. Contingency plans should take into account both inshore and offshore impacts. In addition, *research to develop effective countermeasures should be accelerated by the industry* and government") (emphasis added).

[49] *Id.*, recommendation 8, p. 46.

[50] **CE-32**, CNLOPB, Guidelines for Benefits Plan Approval and Reporting Requirements for Exploration Activities in the Newfoundland Offshore Area (Apr. 14, 1986) (hereinafter "1986 Exploration Phase Guidelines").

[51] This has been acknowledged by the Claimants. Claimants' Memorial, ¶¶ 46, 52.

[52] **CE-32**, 1986 Exploration Phase Guidelines, ¶¶ 3.5 and 3.6, pp. 6-7.

benefits delivered to the province, including expenditures on R&D and E&T.[53] The 1986 Exploration Phase Guidelines stated that guidelines on "expenditure amounts" for R&D and E&T "will be developed by the Board."[54]

40. Hence, before the Board issued its decision concerning the Hibernia Benefits Plan:

- the Environmental Assessment Panel had recommended specific R&D;
- the Environmental Assessment Panel had recommended close monitoring of reports of local benefits;
- the Board had required annual reports describing R&D and E&T expenditures; and
- the Board had indicated that guidelines for expenditure amounts would be developed.

41. Against this background, the Board considered the Hibernia Benefits Plan. John Fitzgerald was one of the Board members at the time. Before joining the Board, he was Deputy Minister of the Province's Petroleum Directorate and co-ordinated the drafting of the Accord Act in NL. He explains that:

> The expectation of the governments and the Board was that the expenditures made by HMDC [Hibernia Management Development Company] on R&D and on education and training in Newfoundland during execution of the Hibernia project would establish an increased capacity and a track record for the local engineering and research communities that would admit them to a larger role in future projects in the local offshore area and would position institutions and companies located in the province to

[53] *Id.*, ¶ 4.2.3, p. 9.

[54] **CE-32**, 1986 Exploration Phase Guidelines, ¶¶ 3.5 and 3.6, pp. 6-7.

> compete successfully for work outside the local market, particularly for work on projects in jurisdictions where the Hibernia partners had interests. In this way there would be a sustained economic benefit from the project and there would be positive consequences from the inevitable linkages that would develop to support the development of other areas of the local economy.[55]

42. The Board was not satisfied that these expectations would be fulfilled by the level of local benefits described in the Plan and asked the operators to submit a Supplementary Benefits Plan.[56]

43. In the Supplementary Hibernia Benefits Plan,[57] the operators stated their commitment to "[c]ontinue to support local research institutions and promote further research and development in Canada to solve problems unique to the Canadian offshore environment."[58] The operators also stated that they "are committed to the following principles for the Hibernia Development Project," one of which is to "[c]arry out a program of timely reporting to the Canada/Newfoundland Board to enable the Board to monitor the level of efforts and benefits achieved and to assist in promoting maximum benefits ..."[59]

44. On this basis, the Hibernia Benefits Plan, incorporating the Supplementary Plan, was approved by Decision 86.01 of the Board in June 1986. In the decision, the Board stated that it "believes that effective monitoring and reporting will be necessary to ensure that the Benefits Plan objectives are accomplished during the execution of the project."[60]

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[55] Fitzgerald Statement, ¶ 60.

[56] Fitzgerald Statement, ¶ 46.

[57] **CE-46**, Mobil Oil Canada, Supplementary Canada/Newfoundland Benefits Plan: Hibernia Development Project (May 28, 1986) (hereinafter "Supplementary Benefits Plan").

[58] *Id.*, p. 7.

[59] *Id.*, pp. 1, 4.

[60] **CE-47**, CNLOPB, Hibernia Decision 86.01, pp. xi and 23 (Jun. 18, 1986) (hereinafter "Hibernia Decision 86.01").

One of those objectives – set out in section 45(3)(c) of the Accord Acts - is for expenditure on R&D and E&T in NL. Consequently, as explained by Mr. Fitzgerald, "the Board stated that it would monitor the proponent's activities to see how well it was meeting its undertakings."[61]

45. By explaining that it would monitor to ensure expenditure on R&D and E&T in NL, the Board conveyed that it would intervene and require more if expenditures were inadequate; otherwise, there would be no reason to monitor. Indeed, in the decision approving the Hibernia Benefits Plan, the Board expressed its expectation that the proponents would respond to requirements to increase local benefits:

> The development and implementation of a benefits plan is, because of the nature of the subject matter, an evolutionary process. The Board has found the Proponent willing to amend its positions to comply with regulatory requirements and to respond positively to issues of concern. *It is the Board's expectation that the Proponent's demonstrated responsiveness in the area of benefits will continue through the duration of the project.*[62]

46. At the time of Decision 86.01, which approved the Hibernia Benefits Plan, the Board did not issue detailed R&D and E&T expenditure requirements. John Fitzgerald explains that:

> While the Board was confident it had the authority to decide whether the proponent's plan for expenditures for these purposes was acceptable, it did not consider that it would be appropriate to exercise that authority by stipulating the amount that should be expended at so early a stage of development in the offshore area. It was conscious that if it set an explicit expenditure level early on that later proved to be too low, it would be very difficult to increase it later. [63]

47. Hence, the Board:

[61] Fitzgerald Statement, ¶ 47.

[62] **CE-47**, Hibernia Decision 86.01, p. 8, emphasis added.

[63] Fitzgerald Statement, ¶ 50.

> elected to monitor both the proponent's performance and the capacity in the local scientific and engineering community to do other work and the development of education and training programs. It would reserve judgement on the effectiveness of the proponent's initiatives until experiential evidence was available. It felt it could then consider whether the proponent was acting in good faith and whether a more explicit undertaking, including setting an amount that should be spent for these purposes, should it be required.[64]

48. Decision 86.01 did not give the Claimants the right to decide whether to spend on R&D and E&T based solely on project needs, as the Claimants have suggested. Indeed, the two aspects of the decision on which the Claimants rely to support this interpretation provide no such support. First, the Claimants note that the Board imposed specific conditions on its approval of the Hibernia Benefits Plan, such as requiring the operators to "provide ... comprehensive listings of all major contracts ... anticipated,"[65] but did not impose a specific condition with regard to R&D and E&T.[66] However, as explained above,[67] this is because the Board had secured in the Supplementary Benefits Plan the proponents' commitment to report their expenditures on R&D and E&T and decided to monitor those reports before deciding whether to impose specific spending requirements.

49. The second aspect of Decision 86.01 on which the Claimants mistakenly rely to support their interpretation is the Board's statement that "[w]hile the Board's mandate is to ensure that full employment opportunity is given to Canadians and especially to Newfoundlanders, the Board does not support the establishment of specific employment goals, expressed in either absolute or percentage terms, for this project."[68] The Claimants draw from this sentence to conclude that the Board "rejected the imposition of specific

[64] Fitzgerald Statement, ¶ 51.

[65] **CE-47**, Hibernia Decision 86.01, p. 90.

[66] Claimants' Memorial, ¶ 65.

[67] Counter Memorial, ¶¶ 42-44.

[68] Claimants' Memorial, ¶ 67.

targets as a sound measure for compliance with the Accord Acts."[69] The Claimants have no basis for this conclusion.

50. In the part of Decision 86.01 on which the Claimants rely, the Board was addressing the requirement in section 45(3)(d) of the Accord Acts that first opportunity be given to NL goods and services.[70] The Board has consistently accepted that it does not have the authority to impose specific targets to ensure compliance with that section.[71] The Board's comments regarding the requirement in section 45(3)(d) do not address the obligation in section 45(3)(c) to expend on R&D and E&T. Consequently, the Board's comments in Decision 86.01 do not suggest in any way that the Board believed it did not have the authority to intervene if it determined through its monitoring that expenditures were insufficient.

D. The Continuing Obligation to Expend on R&D and E&T was Confirmed in Subsequent Guidelines

1. The 1987 Exploration Phase Guidelines

51. Shortly after the decision approving the Hibernia Benefits Plan, the Board issued the *Exploration Benefits Plan Guidelines: Newfoundland Offshore Area* in 1987 ("1987 Exploration Phase Guidelines").[72] Like the 1986 Exploration Phase Guidelines, the 1987 Guidelines applied only to the exploration phase of the projects and did not apply to the subsequent development and production phases. Nonetheless, the 1987 Exploration Phase

[69] Claimants' Memorial, ¶ 67.

[70] Claimants' Memorial, fn. 112, quoting **CE-47**, Decision 86.01, p. 9 ("While the Board's mandate is to ensure that full employment opportunity is given to Canadians and especially to Newfoundlanders, the Board does not support the establishment of specific employment goals, expressed in either absolute or percentage terms, for this project."). Section 45(3)(d) provides: "A Canada-Newfoundland benefits plan shall contain provisions intended to ensure that: ... (d) first consideration shall be given to services provided from within the province and to goods manufactured in the province, where those services and goods are competitive in terms of fair market price, quality and delivery." **CA-11**, Federal Accord Act.

[71] See Counter Memorial, ¶ 92.

[72] **CE-33**, Exploration Benefits Plan Guidelines: Newfoundland Offshore Area (Apr. 21, 1987), s. 2.2 (hereinafter "1987 Exploration Phase Guidelines").

Guidelines noted the obligation arising from section 45(3)(c) to expend on R&D and E&T in the province:

> Section 45(3)(c) of the legislation requires that a Benefits Plan contain provisions *intended to ensure expenditures are made* for research and development and education and training in the Province. The company is expected to outline its plans in this regard by describing its program and identifying the expenditure amounts.[73]

52. The 1987 Exploration Phase Guidelines also confirmed the obligation of the proponents to submit, in its Annual Report, a description of the R&D and E&T activities undertaken by the company in NL and include expenditure amounts.[74] The 1987 Exploration Phase Guidelines also stated that "[w]hen preparing a Benefits Plan, a company should state its intentions concerning ...utilization of Newfoundland and other Canadian firms and institutions to undertake research and development" and "assistance to...private and public training institutions in identifying and developing suitable pre-employment training programs."[75]

53. While the 1987 Exploration Phase Guidelines did not state that "Guidelines for expenditure amounts ... will be developed by the Board," as had the 1986 Exploration Phase Guidelines, this does not mean that such guidelines were forever "abandoned," as suggested by the Claimants.[76] There was no decision by the Board to do so. Instead, the 1987 Exploration Phase Guidelines simply provided that "[t]hese Guidelines...*may be revised from time to time* following consultation with industry."[77] As explained by John Fitzgerald, the 1987 Exploration Phase Guidelines are "consistent with the approach the Board had adopted in its June 1986 decision on the Hibernia Benefits Plan, i.e., to

[73] Emphasis added.

[74] **CE-33**, 1987 Exploration Phase Guidelines, s. 4.4.

[75] *Id.*, s. 2.2.

[76] Claimants' Memorial, ¶ 49.

[77] **CE-33**, 1987 Exploration Phase Guidelines, s. 1.0, emphasis added.

monitor the proponent's performance in relation to its commitments, to consider its adequacy and to reserve judgement as to whether further action, including the possibility of setting expenditure targets, was required until there was evidence to indicate the need."[78]

2. The 1988 Development Guidelines

54. Shortly after issuing the 1987 Exploration Phase Guidelines, the Board issued the *Development Application Guidelines: Newfoundland Offshore Area* in December 1988 ("1988 Development Guidelines"), which the Claimants fail to mention. That document provided guidance with respect to the preparation of a Benefits Plan under section 45 of the Accord Act.[79] The 1988 Development Guidelines note that after the approval of a Benefits Plan, the proponents "will be required to satisfy the Board's requirements in a number of areas, both prior to and subsequent to the commencement of production operations."[80]

55. The 1988 Development Guidelines stated that project proponents were expected to describe their plans concerning "specific education and training programs, including associated expenditures," as well as their plans concerning "utilization of Newfoundland and other Canadian firms and institutions to undertake offshore-related research and development; and proposed research and development projects, and associated expenditures, to be carried out in the Province pursuant to Sections 45(3)(c) of the Acts."[81] Thus, the 1988 Development Guidelines indicated that R&D spending was "offshore-related," not just related to the needs of the specific project at issue.

56. Under the heading "Consultation, Monitoring and Reporting," the 1988 Development Guidelines stated that:

[78] Fitzgerald Statement, ¶ 54.

[79] Way Statement, ¶¶ 31-34

[80] **RE-9**, CNOPB, Development Application Guidelines: Newfoundland Offshore Area (Dec. 1988), s. 1.5 (hereinafter "1988 Development Application Guidelines").

[81] *Id.*, ss. 5.2.4, 5.2.5, emphasis added.

> Effective monitoring and reporting of procurement decisions and reporting of expenditure and employment levels are necessary to ensure that the principles of the Benefits Plan are being followed and its commitments are being met. Pursuant to this, the proponent is expected to describe it [sic.] plans for monitoring and reporting, on a regular basis, on the efforts of both itself and its contractors in achieving benefits to Canada in general, and to Newfoundland in particular. It is the Board's intention to...require submission, by the proponent, of project expenditure and employment reports on a regular basis. *Details of the Board's monitoring and reporting requirements will be established in consultation with the proponent after submission of the Benefits plan.*[82]

57. Thus, the 1988 Development Guidelines further confirmed that the Board would monitor expenditures on R&D and E&T "to ensure that ... commitments are being met" and that more detailed procedures and requirements would follow. The guidelines also reflect Mr. Fitzgerald's statement that the Board reserved the right to intervene if monitoring revealed that the operators were not fulfilling their commitments.[83]

E. Financial Assistance from Government did not Affect the Claimants' Obligation under the Accord Acts to Expend on R&D and E&T

58. Following the approval of the Hibernia Benefits Plan in 1986, a fall in oil prices jeopardized the project's viability. The project was only resurrected after the federal and provincial governments agreed to substantial financial support. The governments explained that they "anticipate that the Project will be of significant benefit to Canada and Newfoundland and desire to facilitate the development and financing of the Project."[84] The governments committed over $1.1 billion in grants, a loan guarantee of

[82] *Id.*, s. 5.5.2, emphasis added.

[83] Fitzgerald Statement, ¶ 51.

[84] **CE-8**, Hibernia Development Project: Framework Agreement (Nov. 10, 1990), p. 2.

$1.66 billion, a line of credit of $160 million, loans up to $300 million, a reduction of the sales tax and corporate income tax and royalty reductions.[85]

59. The governments' agreement to provide financial support to the Hibernia project was contained in agreements signed with the project owners in 1988 and 1990. In return for receiving this financial support from the governments, the Hibernia proponents agreed to provide further benefits to NL and Canada in addition to the benefits they were already obliged to provide under the Accord Acts and Decision 86.01 approving the Hibernia Benefits Plan.[86] Given that the Acts already required expenditures on R&D and E&T, such expenditures were not part of the further benefits negotiated.

60. The Board, which is required to ensure that the proponents fulfill their obligations under the Accord Acts and Decision 86.01, did not help negotiate, and was not a party to, the 1988 and 1990 agreements. The 1988 and 1990 financial agreements did not affect the Claimants' R&D and E&T obligations arising from the Acts and Decision 86.01. This has not been challenged by the Claimants. The continuing obligation to expend on R&D and E&T remained unchanged.

61. Following the commitment of significant government funds, the Hibernia Project was officially announced on September 14, 1990. While the additional benefits agreed to by the proponents did not relate to R&D or E&T, the federal government stressed at the time the importance of the project for the development of technical knowledge in NL. Canada's Minister of Energy, Mines and Resources stated that "[t]he opening up of this new frontier will put Canadians at the leading edge of offshore development

[85] **CE-7**, Statement of Principles Hibernia Development Project, July 1988, pp. 5-11; **RE-13**, Hibernia Management and Development Company Ltd., *The Hibernia Development [:] "People Pioneering Offshore Excellence [:] 1996 Update*, July 1996, St. John's, Newfoundland, pp. 25-30; **RE-2**, *Financial and Fiscal Elements backgrounder*. The provincial retail sales tax was eliminated on Hibernia capital and was reduced on operating costs from 12% to 4%, while the corporate income tax was reduced to a rate equal to the national average of all provincial corporate income tax. Customs duties were also later reimbursed. **RE-16**, *Order Respecting the Remission of Duties Paid on the Floating Crane "Taklift 7"*, SOR/98-172 (Mar. 19, 1998).

[86] This is acknowledged by the Claimants. Claimants' Memorial, ¶ 69 ("... the project owners negotiated a set of agreements with the governments in which they undertook additional commitments, some related to benefits, in exchange for guaranteed loans and project subsidies, among other things.").

technologies. With these advanced technologies we can expand frontier development even further."[87]

F. The Decision Approving the Terra Nova Benefits Plan Ensured Expenditures on R&D and E&T

62. In 1996, shortly before production would begin on Hibernia, the Benefits Plan for the second project for extraction of oil off the coast of NL, the Terra Nova project, was submitted to the Board. Just as in the Hibernia Benefits Plan, in the Terra Nova Benefits Plan, the proponents committed to report the fulfilment of their obligations under the Plan. The Plan stated: "To ensure benefits are flowing effectively to Newfoundland and other regions of Canada, the Proponents will work with the CNOPB [the Board] to effect efficient monitoring of the Proponents' performance relative to their commitments to this benefits plan."[88] The proponents also said that "[t]he Operator will report to the C-NOPB yearly ... A summary of R&D expenditures reported by program and total expenditure ..."[89]

63. The Terra Nova Benefits Plan was reviewed by a panel organized to consult with the public and examine the environmental, socio-economic and safety impacts of the project. The Terra Nova Project Environmental Assessment Panel emphasized the importance of "basic" R&D and highlighted the need for more spending in particular research areas. According to the Panel:

> When Northern Cod and groundfish stocks collapsed on the Grand Banks it became clear that research beyond the standard

[87] **RE-10**, Government of Canada, News Release: Hibernia Project Underway (Sep. 14, 1990), p. 1. Just as with the Hibernia project, financial assistance was provided to Terra Nova. For example, the federal government agreed to repay about $99 million in customs duties. **RE-51**, *"Terra Nova FPSO" Remission Order*, SOR/2000-188 11 May, 2000, article 1). However, just like Hibernia, the financial assistance provided to Terra Nova did not affect the Claimants' R&D and E&T obligations arising from the Accord Acts and the subsequent decision approving the Terra Nova Benefits Plan. This has also not been challenged by the Claimants.

[88] **RE-12**, Development Application: Terra Nova Development, Canada-Newfoundland Benefits Plan, p. 9-2 (Mar. 31, 1996) (hereinafter "Terra Nova Benefits Plan").

[89] *Id.*, p. 9-4.

> monitoring of stock status was necessary to deal with uncertainty about the factors responsible and to predict future developments. Hence, the Northern Cod Science Program was developed to identify and meet these needs. ... This sort of basic research will also be necessary to lessen the uncertainties of operating petroleum facilities in the Grand Banks environment. *Funding basic research from revenues generated from offshore petroleum resources is a requirement of the Atlantic Accord.*[90]

64. The Panel went on to issue recommendation 51:

> The Panel recommends that the Board require operators of offshore oil projects to *fund basic research.* This initiative should include support of the Department of Fisheries and Oceans to conduct basic research on the mechanisms and processes by which chemicals in produced water may have impacts on the biological community. Also, support for research on cumulative and sub-lethal effects should be included.[91]

65. Furthermore, the Environmental Assessment Panel stressed the need for the Board to monitor the proponent's compliance with its benefits commitments.[92]

66. Following the release of the report of the Terra Nova Project Environmental Assessment Panel, the Board issued its assessment of the Benefits Plan. The Board stated that it was dissatisfied with the operator's commitments to expend on R&D in the province:

> The Proponent's commitments vis-à-vis its future support of such [R&D] activities are at best qualified, particularly inasmuch as there is no measure of the level of effort the Proponent intends to make in this regard (e.g., there are no expenditure estimates provided in the Benefits Plan). While the relevant provisions of the Accord Acts do not prescribe levels of expenditure, the Acts require that the Benefits Plan contain provisions intended to ensure

[90] **RE-14**, Report of the Terra Nova Project Environmental Assessment Panel (Aug. 1997), p. 49, emphasis added.

[91] *Id.*, p. 50, emphasis added.

[92] *Id.*, recommendation 23, p. 26 ("The Panel recommends that the Board commence a regular public information program to update the people of the Province on the results of its compliance monitoring efforts ...").

> that expenditures are made on research and development in the Province.[93]

67. The Board went on to state that "the [Terra Nova Project Environmental Assessment] Panel's recommendation [51] related to funding basic research is consistent with the thrust of this legislative requirement."[94]

68. After endorsing the Panel's recommendation that the operators fund "basic research," the Board went on to state that the Terra Nova Benefits Plan "does not fully satisfy the statutory requirement that the Benefits Plan contain provisions intended to ensure that expenditures are made on research and development and education and training in the Province."[95]

69. To ensure expenditures on R&D and E&T, the Board imposed specific reporting requirements on the operators of the Terra Nova project:

> The Board appreciates the difficulty in providing, in advance, detailed research and development and education and training plans for the entire duration of the Development and, therefore, to provide a framework for monitoring the Proponent's activities in this regard, establishes a condition to its approval of the Benefits Plan that:
>
> > The Proponent report to the Board by March 31 of each year, commencing in 1998, its plans for the conduct of research and development and education and training in the Province, including its expenditure estimates, for a three-year period and on its actual expenditures for the preceding year.[96]

70. The Board went on to emphasize that it would monitor to ensure that the proponent met its commitment to expend on R&D and E&T in the province:

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[93] **CE-57**, CNLOPB, Terra Nova Decision 97.02, (Dec. 1997), p. 23, s. 3.5.1 (hereinafter "Terra Nova Decision 97.02").

[94] *Id.*, p. 23, s. 3.5.1.

[95] *Id.*, p. 24, s. 3.5.3.

[96] *Id.*, p. 24, s. 3.5.3.

> The Board believes the Proponent's commitments in the Benefits Plan will be fulfilled. However, *the Board also has an obligation as the regulator to ensure that the Proponent's commitments are met.* Accordingly, it will develop, in consultation with the Proponent, reporting mechanisms for the timely review of contracts, and appropriate reporting formats for tracking employment and expenditures. This Board will conduct periodic audits to confirm the accuracy of the reports.[97]

71. Consequently, in its decision approving the Terra Nova Benefits Plan, just as in its decision approving the Hibernia Benefits Plan, the Board stated that it would monitor to ensure expenditures on R&D and E&T in the province. The Board enhanced the Claimants' reporting to better enable the Board to monitor expenditures. Just as in its decision approving the Hibernia Benefits Plan, by stating that it would monitor such expenditures, the Board conveyed that it would require an increase if expenditures were inadequate. Otherwise, there would be no reason to monitor and the Board could not "ensure that the Proponent's commitments are met." As explained by John Fitzgerald, "the Board signalled its intention to judge the adequacy of the proponent's past performance and its short term plans each year."[98]

72. The plain words of Decision 97.02 and the explanation of that decision by Mr. Fitzgerald demonstrate that it did not give the Claimants' the right to decide whether to spend on R&D and E&T based solely on project needs, as the Claimants now assert. The two aspects of the decision on which the Claimants rely do not support this interpretation.

73. First, the Claimants rely on the Board's unremarkable statement that section 45(3)(c) of the Accord Acts does "not prescribe levels of expenditure."[99] While the section does not prescribe such levels it does provide that expenditures "shall" be made, as the Board notes in the same sentence. Thus, in the next sentence, the Board endorsed Recommendation 51 of the Environmental Panel that "the Board *require* operators of

[97] *Id.*, p. 2, s. 1.2., emphasis added.

[98] Fitzgerald Statement, ¶ 68.

[99] **CE-57**, Terra Nova Decision 97.02, s. 3.5.1, quoted in Claimants' Memorial, ¶ 77.

offshore oil projects to *fund basic research.*"[100] Indeed, it is because section 45(3)(c) does not prescribe levels of expenditure that the Board was ultimately required to issue the Guidelines which are the subject of this arbitration.

74. The second aspect of Decision 97.02 on which the Claimants rely to support their interpretation of the decision is the Board's failure to "impose an R&D expenditure requirement as a condition to its approval of the Benefits Plan."[101] However, as explained above,[102] instead of imposing a specific expenditure requirement, the Board decided to monitor expenditures and intervene later if necessary.

75. Hence, the two aspects of Decision 97.02 on which the Claimants rely do not support their interpretation of the decision. Nor does the additional document on which they rely. The Claimants rely on minutes of a meeting between Petro-Canada, the Terra Nova project proponent, and the Board before the Benefits Plan was submitted. Specifically, the Claimants rely on a note that "the Petro-Canada officials seemed to be well informed of the requirements of the Atlantic Accord Acts and the [1987 Exploration Phase] Guidelines. To a large extent, they see the benefits requirements to be 'process' oriented rather than related to prescribed targets and outcomes."

76. It is true that, to a large extent, the benefits requirements under the Accord Acts are process oriented rather than related to prescribed targets and outcomes. The requirement in 45(3)(b) of the Accord Acts that "residents in the Province shall be given first consideration for training and employment" is process oriented. Similarly, the requirement in 45(3)(d) that "first consideration shall be given to" provincial goods and services is also process oriented.

77. However, just because the benefits requirements under the Accord Acts are largely process oriented does not mean that they *all* are. In contrast to sections 45(3)(b)

[100] Emphasis added.

[101] Claimants' Memorial, ¶ 79.

[102] Counter Memorial, ¶ 71.

and (d), section 45(3)(c) *is* related to targets and outcomes. It provides that expenditures on R&D and E&T *shall* be made in the province.

78. In sum, there is nothing in the Claimants' Memorial which disrupts the plain terms of Decision 97.02 approving the Terra Nova Benefits Plan. As explained by Mr. Fitzgerald, and accepted by the Canadian courts,[103] the decision required reporting of expenditures on R&D and E&T to ensure the proponents fulfilled their obligations under section 45(3)(c). If reporting revealed that expenditures were inadequate, the Board had the authority to impose specific requirements.

G. The Claimants Initially Reported Significant R&D and E&T Expenditures, Including Expenditures Beyond those Necessary for the Projects

79. Following the approval of its Benefits Plan, the Hibernia project went on to produce oil and has generated significant revenues for the Claimants. According to the Claimants, Hibernia's revenues between 2004 and 2008 were $19.3 billion,[104] while projected revenues between 2009 and 2036 are [redacted][105] Similarly, the Terra Nova project has generated significant revenues for the Claimants. The Claimants state that Terra Nova revenues between 2004 and 2008 were $10.7 billion,[106] while projected revenues between 2009 and 2018 [redacted][107]

80. The Claimants initially spent significantly on R&D and E&T. For example, between 1991 and 1995 alone, the Hibernia proponents reported to the Canadian tax

[103] See further Counter Memorial, ¶¶ 131-141.

[104] Expert Report of Howard Rosen, Appendix B, Schedule 2, p. 2 (hereinafter "Rosen Report").

[105] *Id.*, Schedule 2, pp. 2-4.

[106] *Id.*, Schedule 3, p. 6.

[107] *Id.*, Schedule 3, pp. 6-7.

authorities spending on R&D of over $84 million.[108] Between 1998 and 2000, the Terra Nova proponents spent over $12 million on E&T.[109]

81. In the face of this significant spending on R&D and E&T, there was no need for the Board to intervene and establish a minimum level of expenditures.

82. The early expenditures also indicated that the Claimants understood that their obligation was to help provide for the sustainable development of the province rather than just spend what was necessary for the projects. Much of the reported R&D and E&T expenditures were not necessary for the projects. For example:

- sponsorship of an Industrial Research Chair in Ocean Engineering at Memorial University ("MUN");[110]
- sponsorship of the furnishing of a classroom for the MUN Centre of Management Development;[111]
- donation to C-CORE's general trust fund;[112]
- funding for the establishment of a junior research Chair in Ocean Environmental Risk Engineering at MUN; [113] and
- funding for the MUN Chair for Women in Science in Engineering.[114]

[108] **CE-144**, Hibernia SR&ED Acceptance Chart (July 2009).

[109] **CE-96**, Terra Nova 2007 Benefits Report, p. 21.

[110] **CE-62**, Hibernia 1986 Benefits Report, s. d (2).

[111] **CE-66**, Hibernia 1987 Benefits Report, s. E.

[112] **CE-68**, Hibernia 1989 Benefits Report, s. D(3).

[113] **CE-81**, Terra Nova 1999 R&D Benefits Report, p. 5.

[114] **CE-88**, Terra Nova 2000 E&T Benefits Report, p. 11.

83. Indeed, in its reports on R&D and E&T expenditures, the Terra Nova proponents clearly acknowledged that it was reporting expenditures not necessary for the project. For example, in their March 1999 report on expenditures on R&D, the Terra Nova proponents reported that they "will continue to support technically worthy research and development activities and programs in the province where the results of such activities and programs have application to the Terra Nova Development and/*or* to the development of an offshore oil industry in the province."[115] Similarly, in the E&T report submitted at the same time, the proponents state that "[i]n addition to implementing training initiatives aimed at meeting the specific training requirements of the development, the Proponents also continue to work actively ... in various areas related to the furthering of opportunities for the establishment of offshore related skills in the province."[116]

84. The reports of R&D and E&T expenditures which were not necessary for the projects are inconsistent with the Claimants' current position that the Accord Acts only required R&D and E&T expenditures necessary for the projects.[117] If these expenditures were not required, as the Claimants now assert, then there would be no reason for the Claimants to make such expenditures and include them in their reports to the Board.

H. The Board Intervened When Reporting Indicated that the Operators Were Not Fulfilling their Commitment to Expend on R&D and E&T

85. Consistent with its decisions approving the Hibernia and Terra Nova Benefits Plans, the Board closely monitored the proponents' annual benefits reports to ensure that they were fulfilling their obligations. For example, in February 2000, the Chair circulated

[115] **CE-81**, Terra Nova 1999 R&D Benefits Report, p. 8, emphasis added.

[116] **CE-82**, Terra Nova 1999 E&T Benefits Report, p.3.

[117] Claimants' Memorial, ¶ 72.

a memorandum to other Board members, in which he reviewed and assessed the reports on R&D and E&T for the Terra Nova project.[118]

86. The Board not only monitored expenditures on R&D and E&T, but intervened when it felt that expenditures were insufficient. For example, in February 1999, the Board wrote to Petro-Canada to "express a measure of concern with the approach to the 'Glory Holes' project." Glory holes are large holes drilled in the sea-bed. The Board stated:

> The requirement for glory holes is a uniquely Canadian requirement; in fact the requirement is unique to the offshore Newfoundland and Arctic operating environments. Iceberg management and the ice-seafloor interaction are critical factors in the Newfoundland offshore area.
>
> This is a legitimate research and development target for operators in the Newfoundland offshore area, as evidenced by failure of 1998 efforts to excavate the glory holes. Section 45(3)(c) of the Atlantic Accord legislation specifically requires that expenditures for research and development be carried out in the Province ...[119]

87. Thus, the Claimants are incorrect when they state that "the Board accepted the R&D expenditure levels reported without apparent scrutiny or comment" and "[p]rior to the introduction of the 2004 Guidelines, the Board never once expressed dissatisfaction with the R&D expenditures reported by either project."[120] While the Board did not intervene often, this was because reported expenditures were satisfactory. This changed in 2001.

[118] **RE-20**, Memorandum from H. Stanley, CNOPB, to Board Members (Feb. 11, 2000).

[119] **RE-18**, Letter from H. Stanley, CNOPB, to G. Bruce, Petro-Canada (Feb 3, 1999). See also, **RE-17**, Letter from H. Stanley, CNOPB, to G. Bruce, Petro-Canada (Jun. 30, 1998).

[120] Claimants' Memorial, ¶ 89.

I. When Monitoring Revealed a Significant Decline in Expenditures on R&D and E&T in 2001, the Board Quickly Described its Expectations

88. Around 2001, the Claimants began to report decreasing expenditures on R&D and E&T.[121] Hibernia's reported R&D and E&T expenditures decreased by almost 50% from 1998 to 2001.[122] The Terra Nova Annual Benefits Report for the year 2001 projected only $300,000 to $400,000 as the average annual expenditures for R&D and E&T until the end of 2004.[123] This decline in expenditures on R&D and E&T raised concerns with the Board that the operators were not fulfilling the requirement under the Accord Acts to expend on R&D and E&T.[124]

89. At the same time as its monitoring raised concerns that the operators were not fulfilling their obligation to expend on R&D and E&T in the province, the Board had an opportunity to clarify that obligation. In 2001, as part of its review of the Benefits Plan for the third project off the coast of Newfoundland, called White Rose, the Board considered the report of a Public Review Commissioner, as provided for under section 44 of the Accord Acts.[125] The Commissioner had recommended that the Board "release publicly a definitive statement as to how the Board intends to interpret the Atlantic Accord and the Accord Acts and how the Board will implement or administer it [sic] benefits responsibilities, including requirements for, and evaluation of, the Benefits Plans."[126]

[121] First Witness Statement of Frank Smyth, ¶ 6 (hereinafter "Smyth Statement").

[122] Way Statement, ¶ 42.

[123] **CE-90**, Canada-Newfoundland Benefits Annual Report, Terra Nova Development For the Year 2001, p. 35 (hereinafter "2001 Terra Nova Benefits Report").

[124] Way Statement, ¶ 44.

[125] **CA-11**, Federal Accord Act, s. 44(1).

[126] **RE-22**, CNLOPB, White Rose Decision 2001.01, p. 151 (Nov. 26, 2001) (hereinafter "White Rose Decision 2001.01").

90. The Board agreed with the Commissioner's recommendation that the time had come to publicly interpret the benefits requirements of Accord Acts. Consequently, in its decision approving the White Rose Benefits Plan, the Board explained that:

> [s]ince the Legislation simply requires that expenditures [for R&D and E&T] be made for these purposes in the Province, latitude is left to the Board to establish parameters and criteria for such expenditures. This statutory requirement is intended to ensure that the Proponent describes its plans and financial commitments to research & development and education & training in the Province. The amount of financial contribution in this area is expected to be consistent with national norms for such expenditures by the private sector.[127]

91. Despite this clear statement, the Claimants rely on the decision approving the White Rose Benefits Plan to argue that the Board has acknowledged it had no such authority.[128] However, just as it did when interpreting the decision approving the Hibernia Benefits Plan,[129] the Claimants confuse statements of the Board regarding section 45(3)(d) of the Accord Acts with statements regarding section 45(3)(c).

92. The Claimants' argument is based solely on the following sentence from the decision approving the White Rose Benefits Plan: "There is no requirement in the Accord or the Legislation that Benefits Plans be designed to ensure that economic Benefits are delivered to Newfoundland & Labrador and Canada."[130] However, this sentence is bracketed by sentences referring to the requirement in subsection 45(3)(d) of the Accord Acts that first consideration be given to provincial goods and services. Thus, the Board was referring to this requirement, not the requirement to expend on R&D and E&T within subsection 45(3)(c). This is made clear by the remainder of the White Rose

[127] *Id.*, p. 18.

[128] Claimants' Memorial, ¶ 97 ("the Board specifically acknowledged that, while that [sic.] the Atlantic Accord and the Accord Acts contemplate opportunities being provided to Canadians and Newfoundlanders on a competitive basis, they do not require that benefits actually be delivered.").

[129] See Counter Memorial, ¶ 50.

[130] **RE-22**, White Rose Decision 2001.01, p. 15, s. 3.2.1, quoted in Claimants' Memorial, ¶ 97.

Decision, where the Board acknowledges that subsection 45(3)(d) leaves it with no discretion to set targets on the purchase of local goods or services:

> For goods and services the Legislation affords no scope for latitude on the Board's part as to how it should be implemented. The Legislation requires that a plan be presented which prescribes a competitive process. It does not contain any authority to establish local content targets, or to require the Proponent to establish such targets.[131]

93. In contrast, in the section of the White Rose Decision which addresses subsection 45(3)(c) and the requirement to expend on R&D and E&T, the Board expressly acknowledged that it does have the "latitude … to establish parameters and criteria for such expenditures."[132] Further to this understanding, the Board required the proponent to spend at least $12 million on R&D and E&T prior to production.[133]

94. Indeed, Frederick Way, who was Vice-Chair of the Board at time, explains that in the decision the Board "focused on the distinction between the process requirements for matters such as the procurement of Goods and Services and R&D and E&T for which the legislation actually requires that 'expenditures shall be made'…"[134]

95. Thus, contrary to the Claimants' assertion, the decision approving the White Rose Benefits Plan is perfectly consistent with the view that the Accord Acts enable the Board to set R&D and E&T expenditure targets. Indeed, the Board used the decision to set such targets and promised that it "will proceed in the coming months to revise its Benefits Guidelines along the lines described in this document."[135] The Board proceeded to do just that.

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[131] *Id.*, p. 19, s. 3.2.2.4.

[132] *Id.*, p. 18, s. 3.2.2.3.

[133] *Id.*, p. 31, s. 3.3.3.3.

[134] Way Statement, ¶ 48.

[135] **RE-22**, White Rose Decision 2001.01, p. 25.

J. The Board Developed Guidelines Concerning Expenditures on R&D and E&T

1. The Board Researched National Norms for R&D and E&T Expenditures by the Private Sector

96. To develop its guidelines on R&D and E&T expenditures required by the Accord Acts, the Board examined "national norms for such expenditures by the private sector." The Board commissioned a report in 2002 which considered levels of expenditure both generally and specifically in the petroleum industry.[136] The Board subsequently examined reports by Statistics Canada on average R&D expenditure by oil companies in Canada and internally discussed these reports.[137] The Board produced draft guidelines in August 2002,[138] which were revised in July 2003 following internal discussion.[139]

2. The Board Consulted with the Claimants on the Draft Guidelines for Fifteen Months

97. The July 2003 draft of the Guidelines was presented to the Hibernia Management and Development Company ("HMDC") – the operating company for the Hibernia project owned by the Claimants and other Hibernia proponents - that same month.[140] In this presentation, the Board explained that the rationale of the draft Guidelines was to ensure effective administration of section 45 of the Accord Acts[141] and that the exploitation of offshore petroleum created a lasting economic legacy for the people of the province,

[136] **RE-23**, James Feehan, Ph.D., Statistics on Industry R&D Expenditures for Canada-Newfoundland Offshore Petroleum Board (Mar. 2002) (hereinafter "Feehan Report").

[137] For example, see **RE-24**, Presentation by CNLOPB, Industrial Relations Department "Research and Development, a Presentation to the C-NOPB" (Apr. 2002).

[138] **CE-37**, CNLOPB, Draft Guidelines for Research and Development / Education and Training Expenditures (Aug. 2002) (hereinafter "August 2002 Draft Guidelines").

[139] **CE-40**, CNLOPB, Draft Guidelines for Research and Development Expenditures (Jul. 2003) (hereinafter "Consultation Draft").

[140] **CE-127**, Presentation by CNLOPB to HMDC, Draft Guidelines for Research and Development Expenditures (Jul. 24, 2003) (hereinafter "Presentation by CNLOPB to HMDC").

[141] *Id.*, slide 4.

consistent with the purpose of the Acts.[142] At about the same time, the Board presented the draft Guidelines to Petro-Canada, the operator of the Terra Nova project.[143]

98. In October 2003, the Canadian Association of Petroleum Producers ("CAPP") met with the Board and presented a consolidated industry position opposing the Guidelines.[144] At that meeting, the Board indicated its willingness to consider operator feedback.[145] CAPP maintained its opposition to the Guidelines, in particular the requirement to expend a minimum amount on R&D and E&T in the province.[146] CAPP did not criticize the actual benchmark within the draft Guidelines or present an alternative to fulfil the requirement in section 45(3)(c) of the Accord Acts for expenditures on R&D and E&T in the province.

99. The Board responded to CAPP's letter on February 9, 2004, inviting CAPP to "present its views on 'ways of encouraging and promoting research and education'."[147] CAPP responded on March 23, 2004, indicating that it was working on a "strategic approach" to R&D in the province.[148] Since this strategy did not include commitments for levels of expenditure by industry,[149] the Board gave industry a further opportunity to

[142] *Id.*, slide 5.

[143] **RE-27**, Presentation by CNLOPB to Petro-Canada: "Draft Guidelines for Research and Development Expenditures" (Jul. 22, 2003).

[144] **RE-28**, Presentation by CAPP: "C-NOPB Research and Development Expenditure Guidelines: CAPP Response" (Oct. 27, 2003).

[145] **CE-132**, Meeting Minutes, CNLOPB / Industry Representatives (Oct. 28, 2003).

[146] **CE-133**, Letter from P. Alvarez, CAPP, to H. Stanley, CNLOPB (Nov. 14, 2003).

[147] **RE-29**, Letter from H. Stanley, CNLOPB, to P. Alvarez, CAPP (Feb. 9, 2004).

[148] **RE-30**, Letter from R. P. Barnes, CAPP, to H. Stanley, CNLOPB (Mar. 23, 2004).

[149] **RE-33**, Presentation by CAPP: "Proposed East Coast Oil and Gas Operators Strategy to Encourage and Promote Research and Development and Education and Training in Newfoundland and Labrador" (May 11, 2004).

consult with the proviso that any proposal should result in expenditures close to the average expenditure on R&D by oil companies in Canada.[150]

100. In May 2004, the Board met with HMDC to discuss the Guidelines and potential alternatives. At this meeting, HMDC's proposal to only conduct R&D and E&T necessary for the projects was rejected by the Board.[151] The Board met with the operators again in June. The operators asked for an explanation of the policy intent of the Guidelines, with particular focus on the concept of developing a "legacy" for the province. The Board explained the process it had undertaken in the context of the White Rose decision, the research done to arrive at the benchmark and its position that this benchmark was reasonable, in view of the data considered. The Board indicated that it was "open-minded and prepared to be creative," but wanted a quantifiable commitment to be part of any solution.[152]

101. In June 2004, the Board agreed to postpone the implementation of the Guidelines while the operators sought an alternative solution on the understanding that, if no alternative was found, the Guidelines would apply from the previous April.[153]

102. In July 2004, the Board met again with the operators and encouraged them to provide an alternative proposal in writing.[154] Such a proposal was never provided.

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[150] **CE-135**, Memo from J. MacDonald, to CNOPB / Industry Representatives: Meeting Notes from R&D Meeting with CAPP, May 11, 2004 (May 14, 2004).

[151] **CE-136**, Memo from J. MacDonald, to CNOPB / Industry Representatives: Meeting Notes from R&D Meeting with Exxon Mobil, May 26, 2004 (May 26, 2004).

[152] **CE-137**, Meeting Minutes, CNLOPB / Industry Representatives, "Draft Guidelines on R&D/E&T" (Jun. 3, 2004).

[153] **CE-41**, Letter from F. Way, CNLOPB, to J. Taylor, HMDC (Nov. 5, 2004) and **CE-42**, Letter from F. Way, CNLOPB, to G. Carrick, Petro-Canada (Nov. 5, 2004) ("This led to a meeting in early June 2004...We expressed at that time a concern with respect to the response time for such a proposal and noted that the effective date of the guidelines, or any acceptable alternative industry proposal, would be April 1, 2004.").

[154] **RE-31**, Memorandum from F. Smyth to file, Meeting at CNOPB Offices to Discuss R&D and the July 21, 2004 Board Meeting (Jul. 23, 2004).

103. In the light of industry's failure to offer a viable counter-proposal, the Board released the Guidelines on November 5, 2004.[155] The Guidelines specified that they were in effect from April 2004, as the Board had indicated earlier in the year when it allowed for further consultations through the summer and the fall. The Board conditioned its 2005 POAs for the Hibernia and Terra Nova projects, which were both up for renewal, on compliance with the Guidelines.[156] Nevertheless, the Board agreed to postpone the enforcement of the Guidelines while the operators challenged them before domestic courts.[157] Following the failure of the domestic challenge, the Board required the Claimants to fulfil their obligation to meet the Guidelines from April 1, 2004.[158] This did not involve any "retroactive" enforcement, as the Claimants now assert,[159] since the Board always indicated to the Claimants that they would be required to meet the Guidelines from this date if the domestic challenge failed.[160]

K. The Guidelines are Reasonable and Reflect Industry Spending

1. The Guidelines Require Expenditures on R&D and E&T Consistent with Industry Norms

104. The Guidelines explain that "an operator, or group of operators, may propose an R&D [and E&T] program in lieu of the requirement of the guidelines."[161] In the absence of such a proposal accepted by the Board, operators must expend a minimum amount on

[155] **CE-41**, Letter from F. Way, CNLOPB, to J. Taylor, HMDC (Nov. 5, 2004); **CE-42**, Letter from F. Way, CNLOPB, to G. Carrick, Petro-Canada (Nov. 5, 2004).

[156] **CE-103**, Hibernia POA (Nov. 2, 2005); **CE-107**, Terra Nova POA (Jan. 27, 2005).

[157] **CE-115**, Letter from I. Kelly, Curtis Dawe Barristers, Solicitors & Notaries, to J. Thistle, McInnes Cooper, Barristers & Solicitors (Mar. 3, 2005).

[158] **CE-116**, Letter from F. Smyth, CNLOPB, to P. Sacuta, HMDC (Feb. 26, 2009) (Rosen Exhibit 21); **CE-117**, Letter from F. Smyth, CNLOPB, to G. Vokey, Petro-Canada (Mar. 3, 2009) (Rosen Exhibit 22).

[159] Claimants' Memorial, ¶ 115.

[160] **CE-115**, Letter from I. Kelly, Curtis Dawe Barristers, Solicitors & Notaries, to J. Thistle, McInnes Cooper Barristers & Solicitors (Mar. 3, 2005).

[161] **CE-1**, Guidelines, p. 1.

R&D and E&T throughout the life of the projects, that is, throughout the exploration, development, and production phases.[162]

105. Expenditure on R&D and E&T during the exploration phase can be credited against the requirement for the development or production phases.[163]

106. During the development phase, operators are required to spend 0.5% of their "capital cost," which is the "amount of money required to develop a project to first production of oil."[164] The Board included this percentage requirement after reviewing the percentage of project capital cost spent on R&D during the development phases of the White Rose project and Sable Island project off the coast of Nova Scotia.[165] These projects "were felt to be recent and relevant reference points for this purpose."[166] Development phase spending in excess of 0.5% of capital cost will be credited in the production phase.[167]

107. Since both the Hibernia and Terra Nova projects were already past their development phase and into their production phase when the Guidelines were issued in 2004, and the Guidelines do not operate retroactively, only the production phase requirement is the focus of the Claimants' Memorial.

108. During the production phase, operators are required to spend the average R&D expenditure by oil and gas extracting companies in Canada in the previous five-year period.[168] This average, or the production phase benchmark that operators must meet, is

[162] *Id.*, pp. 1-2.

[163] Smyth Statement, ¶ 35.

[164] **CE-1**, Guidelines, s. 2.2.1; Smyth Statement, ¶ 10.

[165] Smyth Statement, ¶ 10.

[166] *Id.*

[167] Smyth Statement, ¶ 36.

[168] **CE-1**, Guidelines, s. 2.2.

determined by statistics gathered by Statistics Canada. For example, the benchmark for 2004 was 0.46%.[169] Thus, in any particular year of a project, project operators must spend on R&D and E&T in the province this benchmark multiplied by the operator's revenue in that year. Revenue in the year is the price of oil in that year multiplied by the production of oil in that year. Hence, required spending during the production phase is determined by the formula: benchmark, multiplied by the price of oil, multiplied by oil production.

109. Expenditures on R&D and E&T during the exploration and development phases are deducted from the spending obligation in the production phase.[170] Both the Hibernia and Terra Nova projects were already in the production phase when the Guidelines came into effect in April 2004 and both projects have been awarded credit for the development phase.[171]

2. The Guidelines are Flexible

110. Not only do the Guidelines expressly allow operators to propose an R&D and E&T program in lieu of fulfilling their requirements, as explained above, the Guidelines are flexible in other ways:

- If the operators of a project spend more than required during a POA period, the additional funding can be applied against requirements in the next POA period.[172] Even if the additional funding is not applied against requirements in the next POA period, additional funding can be applied against requirements in any subsequent POA period.[173] The Claimants are incorrect when they state that overspending not applied against the

[169] **CE-114**, Letter from F. Way, CNLOPB, to J. Taylor, HMDC (Feb. 18, 2005).

[170] **CE-1**, Guidelines, s. 2.2.2; Smyth Statement, ¶¶ 34-35.

[171] Smyth Statement, ¶ 34.

[172] **CE-1**, Guidelines, s. 4.2.

[173] Smyth Statement, ¶ 37.

requirement in the subsequent POA period cannot be applied in later POA periods.[174]

- If the operators of a project spend less than required during a POA period, and there is no overspending in previous periods on which the operators can draw, the shortfall *may* be paid into a fund.[175] If a shortfall is paid into a fund, the Board and the operators will jointly decide the R&D and E&T on which that fund is spent.[176] The fund mechanism "protect[s] against forcing spending to take place in an artificially short period of time."[177] The Claimants are incorrect when they state that any shortfall must be paid into a fund;[178] operators are able to make up the shortfall in other ways.[179]

- Operators can claim credit for expenditures during the exploration phase as well as excess expenditures during the development phase.[180]

- Operators can fulfil their obligation through expenditures by contractors and sub-contractors.[181] Consequently, the comments of the Claimants' expert, David Montgomery, that oil companies contract out their R&D[182] is irrelevant.

[174] Claimants' Memorial, ¶ 111.

[175] **CE-1**, Guidelines, s. 4.2.

[176] *Id.*, s. 4.2.

[177] Smyth Statement, ¶ 40.

[178] Claimants' Memorial, ¶ 111.

[179] Smyth Statement, ¶ 40.

[180] Smyth Statement, ¶ 35.

[181] **CE-1**, Guidelines, s. 3.2.

[182] Montgomery Report, ¶¶ 17-20.

- Operators can determine their distribution of spending between R&D and E&T.[183]

- The Guidelines do not include a rigid definition of eligible R&D and E&T expenditures. They merely provide that "R&D may include: R&D activity in the Province; Increased R&D capacity in the Province; [and] Education & Training activity/capacity in the Province."[184] The Guidelines also state that eligible expenditures include, but are not limited to, R&D expenditures which qualify for the Scientific Research and Experimental Development ("SR&ED") tax deduction under the Income Tax Act. Section 3.4 of the Guidelines further clarifies that eligible E&T expenditure includes: "support for the establishment and/or maintenance of education and training infrastructure; support for technology transfer or including the advancement of trades training; support for Chairs and Fellowships; Scholarships and work terms including provincial residents who may study or work outside the Province." The broad definition of eligible R&D and E&T expenditures provides the Claimants with flexibility when determing how to spend. The Claimants fail to acknowledge this benefit when they criticize the definition for providing insufficient direction.[185]

3. Pre-Approval of Expenditures Provides Certainty to the Operators

111. The Guidelines require that R&D and E&T expenditures are approved by the Board before those expenditures are undertaken. This provides security to the operators

[183] Smyth Statement, ¶ 41.

[184] **CE-1**, Guidelines, s. 3.3.

[185] Claimants' Memorial, ¶ 112.

by preventing them from undertaking R&D and E&T projects in the expectation that those projects will be approved, only to discover afterwards that the expenditures are ineligible. As explained by Frank Smyth, who was the Manager of Industrial Benefits Policy and Regulatory Co-ordination at the Board when the Guidelines were developed:

> The guidelines suggest a pre-approval process for projects as means of providing Operators some certainty in appreciating the status of spending throughout a POA period, rather than waiting until the end of the POA period to understand the status compared to the obligations.[186]

4. The Required Expenditure Benchmark is a Fair Estimate of Average R&D Spending by Oil Companies in Canada

112. As described above,[187] the level of R&D and E&T spending required in any year during the production phase, or the benchmark, is the average of R&D spending by oil and gas extracting companies in Canada in the previous five-year period. Statistics Canada, an agency of the Government of Canada, issues an annual report of such spending. The benchmark is the average of spending in the reports from the previous five years.

113. The statistics on which the benchmark is based are collected by Statistics Canada. The data on R&D spending comes from the response to the Research and Development in Canadian Industry annual census survey which combines data from questionnaires and from the SR&ED tax credit program.[188] The data on revenue comes from the survey questionnaire responses and corporate income tax filings with the Canada Revenue Agency ("CRA").[189] The data are collected according to international best practice, as

[186] Smyth Statement, ¶ 43.

[187] Counter Memorial, ¶ 108.

[188] For example, **CE-153**, Statistics Canada, Science, Innovation and Electronic Information Division (SIEID): Research and Development in Canadian Industry Survey, 2008 (hereinafter "Statistics Canada Survey").

[189] **CE-160**, Statistics Canada, Industry Research and Development: Intentions 2008, No. 88-202-X, p. 60 (hereinafter "2008 Intentions Report").

required by *Statistics Canada's Quality Assurance Framework* (2002)[190] and *Statistics Canada Quality Guidelines* (2003).[191]

114. Collected data are grouped according to the North American Industry Classification code system. This system was devised by, and is used throughout, the NAFTA countries.[192] The benchmark in the Guidelines is based on R&D spending by the Oil and Gas Extraction industry group.[193] It is distinct from other oil and gas industry code groups, such as Petroleum Refineries.[194]

115. The Claimants' criticism of those statistics as a source of the Guidelines benchmark is unfounded and betrays a misunderstanding of those statistics and the Accord Acts. The Claimants criticize the statistics because they do not isolate the spending of companies in their unique position,[195] that is, companies operating off the coast of NL several years into the production phase. The Claimants' criticism suffers from a misunderstanding of their R&D and E&T expenditure obligations under the Accord Acts. The Claimants are required to expend on R&D and E&T, regardless of the

[190] Statistics Canada, Quality Assurance Framework, No. 12-586-XIE (Sep. 2002). Available online at: http://www.statcan.gc.ca/pub/12-586-x/12-586-x2002001-eng.pdf.

[191] Statistics Canada, Quality Guidelines, 4th ed., No. 12-539-XIE (Oct. 2003). Available online at: http://www.statcan.gc.ca/pub/12-539-x/12-539-x2003001-eng.pdf.

[192] **RE-35**, North American Industry Classification System (NAICS) (2007). Available online at: http://www.statcan.gc.ca/subjects-sujets/standard-norme/naics-scian/2007/introduction-eng.htm. ("The North American Industry Classification System (NAICS) is an industry classification system developed by the statistical agencies of Canada, Mexico and the United States. Created against the background of the North American Free Trade Agreement, it is designed to provide common definitions of the industrial structure of the three countries and a common statistical framework to facilitate the analysis of the three countries.").

[193] **RE-36**, Statistics Canada, North American Industry Classification System (NAICS) (2007). The Oil and Gas Extraction industry group is a collection of four sub-groups: 211113 Conventional Oil and Gas Extraction CAN, 211114 Non-Conventional Oil Extraction CAN, 213111 Oil and Gas Contract Drilling, 213118 Services to Oil and Gas Extraction CAN.

[194] **RE-37**, Statistics Canada, North American Industry Classification System (NAICS) (2007): 324110 Petroleum Refineries.

[195] Claimants' Memorial, ¶ 113 ("The Statistics Canada study aggregates data received in response to a survey of an undifferentiated sample set of oil and gas companies … Statistics Canada fails to distinguish between the stage in project operations of companies covered by its study.").

R&D and E&T needs of their projects. The particular R&D and E&T requirements of an oil company operating off the coast of NL several years into the production phase do not determine the Claimants' spending obligations. Such requirements are not the focus of the spending benchmark.

116. The Claimants' criticism that the statistics "exclude ... from consideration all companies with no expected R&D spending [and] [i]f those companies were included, the industry benchmark obviously would be far lower"[196] is also misplaced. The Claimants fail to explain why, given that they are required to expend on R&D, they should be compared to companies who do not. Moreover, the Claimants fail to acknowledge that the statistics also *exclude* spending which would significantly *raise* the benchmark. For example, the statistics exclude spending on R&D performed by consultants,[197] spending on R&D outside Canada, [198] spending on E&T and spending on capital such as lands and buildings.[199]

117. The Claimants criticize the statistics because companies may not respond or may "misstate data."[200] Yet, the Claimants fail to acknowledge that those companies have a legal obligation under the Statistics Act to respond and to respond accurately. The penalties for breaching these obligations are fines and imprisonment.[201] Moreover, Statistics Canada follows-up on anomalies in the data contained in survey responses.[202]

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[196] Claimants' Memorial, ¶ 113.

[197] **CE-160**, 2008 Intentions Report, p. 65.

[198] **CE-153**, Statistics Canada Survey, question 5 asks for "expenditures in Canada ...".

[199] **CE-160**, 2008 Intentions Report, p. 29, referring to "*current* intramural research and development expenditures" and not *capital* expenditures.

[200] Claimants' Memorial, ¶ 113.

[201] **RA-50**, *Statistics Act*, R.S.C. 1985, c. S-19, s. 31. See also, **CE-153**, Statistics Canada Survey, p. 1 ("Completion of this questionnaire is a legal requirement under the *Statistics Act*").

[202] **CE-153**, Statistics Canada Survey, at p. 7 acknowledges that Statistics Canada will "verify discrepancies between this report and your last return."

118. Finally, the Claimants' statement that "Statistics Canada issues its report before CRA has determined whether reported expenditures in fact qualify as SR&ED"[203] is incorrect. While the report is issued before some of the SR&ED claims of companies performing large amounts of R&D have been approved, Statistics Canada does not rely on SR&ED data for their R&D spending; it relies on their response to the survey.[204] By contrast, Statistics Canada does rely on the SR&ED data for companies performing smaller amounts of R&D and the majority of those companies "will have their SR&ED approved in time for our publication date."[205]

119. The CRA data on which Statistics Canada relies will sometimes be revised. For example, the data will be revised when CRA's decision in response to an SR&ED claim is successfully appealed. Statistics Canada revises its data to account for these CRA revisions.[206] Consequently, the Claimants' assertion that "[w]hen expenditures reported to Statistics Canada are later denied SR&ED credit, Statistics Canada does not appear to revise its data"[207] is wrong.

120. While Statistics Canada revises its data, these revisions are not incorporated into the benchmark in the Guidelines. Continually revising past benchmarks to account for these revisions in the underlying data would generate uncertainty.[208] Moreover, the effect of not incorporating revisions to spending in one particular year is reduced by basing the benchmark on the average R&D spending over five years.

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[203] Claimants' Memorial, ¶ 113.

[204] **CE-155,** Email chain between R. Schellings, Statistics Canada, and R. Hutchings, ExxonMobil (Oct. 27, 2008), p. 1 (hereinafter "Email chain between R. Schellings and R. Hutchings") ("... all the large performers of R&D are surveyed, we only use their CRA data for verification.").

[205] *Id.*

[206] **CE-160,** 2008 Intentions Report, pp. 28-29 and tables 7-5 and 7-7, where the "r" next to the 2004 and 2005 figures indicates that they have been revised.

[207] Claimants' Memorial, ¶ 113.

[208] Smyth Statement, ¶ 32.

121. Consequently, the Claimants' criticism of the statistics on which the Guidelines benchmark is based is unfounded. The statistics are collected and grouped according to international best practice and the specific criticisms raised by the Claimants are without merit. Indeed, it is telling that:

a) the Claimants fail to acknowledge that the estimate of R&D spending by oil and gas extracting companies in Canada by Statistics Canada is consistent with estimates of that spending in other countries provided in the Report commissioned by the Board;[209]

b) during the entire fifteen months that the Board consulted with the operators over the draft Guidelines, the Claimants did not once raise concerns about the statistics on which the benchmark was based.[210] The Claimants only raised concerns with the statistics on which the benchmark was based when they challenged the Guidelines before Canadian courts. During those proceedings, the Claimants criticized the statistics on precisely the same grounds that they criticize them now.[211] However, the courts rejected this criticism, holding that "[t]he Guidelines take account of the unique nature of the offshore petroleum industry and the limitations of the Statistics Canada data;"[212] and

c) the Claimants have failed to propose an alternative source of data for average spending on R&D by oil companies in Canada.

[209] **RE-23**, Feehan Report, p. 11 ("... it seems that for the 1990s on average R&D spending by large petroleum corporations is equal to approximately 0.5% to 0.8% of their net sales revenues.").

[210] Smyth Statement, ¶¶ 13-28.

[211] **CA-53**, Court of Appeal Decision, ¶ 84 per Justice Welsh ("Hibernia Management and Petro-Canada submitted that it was not reasonable for the Board to develop the formulae using statistics based on industry practice in Canada generally. They pointed to the unique nature of petroleum development in the offshore, the requirement that the expenditures be made in the Province, and the small sample size in the Statistics Canada data.").

[212] **CA-53**, Court of Appeal Decision, ¶ 91 per Justice Welsh.

5. The Required Expenditure Benchmark is Conservative

122. The required expenditure benchmark is not only a fair estimate of average R&D spending by oil companies in Canada, it is a conservative benchmark for the operators to meet for two reasons. First, there are several types of expenditure which qualify under the Guidelines but which are not incorporated in the benchmark. Specifically, spending on E&T, spending on R&D which is not eligible for the SR&ED tax deduction, spending by contractors and sub-contractors, and spending on buildings and lands all qualify under the Guidelines but are not incorporated into the benchmark. Consequently, the Claimants can fulfil their expenditure obligations under the Guidelines while expending much less than the average R&D expenditure by oil companies in Canada.

123. Second, the required expenditure benchmark is conservative because a large proportion of spending towards the benchmark is tax deductible, as explained further below.[213]

6. Specific R&D Requirements Are Not Uncommon in Other Countries

124. Several jurisdictions impose specific requirements for oil and gas companies to support local sustainable development through R&D. For example, Norway has imposed specific requirements on oil companies to expend on R&D in the country since 1979.[214] Furthermore, Brazil imposes requirements significantly higher than the benchmark in the Guidelines. Brazil requires that concessionaires on highly profitable or high production fields expend no less than 1% of gross revenues on R&D.[215] The Brazilian requirement has led to almost U.S.$ 2 billion in R&D expenditures between 1998 and 2008.[216]

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[213] Counter Memorial, ¶ 319.

[214] **RE-34**, Øystein Noreng, "Norway: Economic Diversification and The Petroleum Industry" Vol. XLVII, No. 45, (Nov. 8, 2004), Middle East Economic Survey. Norway has used so-called "50% agreements" requiring operators to conduct at least 50% of research and development in Norway at Norwegian institutions.

[215] **RE-15**, The Regulation of the Petroleum Industry in Brazil, Law No. 9,478, art. 8(X); **RE-32**, Alexander's Gas & Oil Connections, "Brazil's round six tender involves updated bidding requirements," v. 9, issue 15 (Aug. 4, 2004); **RE-3**, Sonia Maria Agel da Silva, "Brazil Round 1: Principal Terms of

7. The Province has Ample Capacity to Absorb the Expenditures required under the Guidelines

125. There is ample need for the expenditures required under the Guidelines and capacity to absorb them.[217] Wade Locke, an Economics Professor with extensive experience researching the capacity of NL to perform R&D, concludes that the province can "easily" absorb the expenditures.[218] Professor Locke bases his conclusion on:

- the ability of NL to easily absorb increased R&D spending over the last decade. He notes that every year since 1997 the province has absorbed an increase of 10%;[219]

- the expertise of the province in oil and gas R&D. He notes that, through Memorial University and associated research centres, NL has expertise in ocean and ice engineering, process engineering, drilling and reservoir engineering, pipeline engineering, offshore structures, offshore safety and autonomous systems, marine and petroleum geology, and exploration geophysics.[220] He also notes that NL has more than fifty full-time

Concession Agreements: Legal Aspects," p. 14; **RE-38**, Luciana Tavares S. Almeida, "The role of ANP in promoting the technological development of the Brazilian oil, gas and biofuel industry," April 2007, pp. 2-5.

[216] **RE-43**, Raphael Queiroz, "ICRARD 2009," Saint John's (Aug. 7, 2009), p. 28.

[217] The Claimants have refused to produce documents concerning the capacity of the Province to absorb R&D expenditures. Canada requested that the Tribunal order the production of these documents (Letter from N. Gallus to the Tribunal, Oct. 6, 2009). The Tribunal is yet to decide on this request. If the Tribunal upholds Canada's request and further documents are produced, Canada reserves its right to rely on those documents in its Rejoinder submissions on the capacity of the Province to absorb R&D expenditures.

[218] Expert Report of Wade Locke, ¶ 4, 136 (hereinafter "Locke Report").

[219] Locke Report, ¶ 37.

[220] First Witness Statement of Ray Gosine, ¶ 9 (hereinafter "Gosine Statement"); First Witness Statement of Charles Randell, ¶¶ 9-11 (hereinafter "Randell Statement"); Locke Report, ¶¶ 70, 73-93, 98-106.

researchers dedicated to energy R&D[221] and a number of specialized research chairs in the area;[222]

- the unique expertise of NL in arctic engineering and the increasing importance of arctic oil reserves;[223] and

- the current spare R&D capacity in the province. For example, since 2004, Petroleum Research Atlantic Canada ("PRAC") was unable to find funding for over $75 million in proposed R&D projects in NL. Projects on ice management and lifeboats in ice conditions were among those not funded.[224]

126. Thus, there is already spare capacity to absorb the expenditures. The Claimants' unsubstantiated assertion that the province does not have capacity to absorb R&D expenditures under the Guidelines[225] is incorrect. Moreover, the assertion is irrelevant since the Claimants can fulfil their obligation under the Guidelines by spending entirely on E&T and the Claimants have not challenged the E&T capacity of NL.[226]

127. The Claimants' assertion that the province does not have the capacity to absorb expenditures under the Guidelines is also irrelevant since expenditures on R&D and E&T will *build* the capacity of NL to absorb future expenditures. For example, the Claimants can fulfil their obligations under the Guidelines by helping to fund three new research

[221] Locke Report, ¶ 70, Appendix Table B19.

[222] Gosine Statement, ¶ 12; Locke Report, ¶ 124-125.

[223] Locke Report, ¶ 94-96.

[224] Locke Report, Appendix Figure B17 and Appendix Table B18.

[225] Claimants' Memorial, ¶ 126; First Witness Statement of Andrew Ringvee, ¶ 13 (hereinafter "Ringvee Statement"); First Witness Statement of Edward Graham, ¶ 10 (hereinafter "Graham Statement").

[226] Redfern Schedule, October 6, 2009, p. 18 ("Claimants confirm that they are not challenging E&T capacity in the Province.").

centres which are planned for the province. Memorial University is currently planning the Centre for Energy Education and Research and Development and the Centre for Research in Environment and Oceans.[227] C-CORE is planning the Centre for Arctic Research and Development.[228] The three centres require an initial infrastructure investment of at least $135 million.[229] Once established, they are expected to be able to absorb over $70 million annually in R&D funding.[230]

L. The Board Issued the Guidelines under the Authority Granted by the Accord Acts

128. The Guidelines explain that they are issued under the authority of sections 45(3)(c) and 151.1(1) of the Accord Acts.[231] Section 45(3)(c) requires Benefits Plans which ensure expenditures on R&D and E&T in the province and section 151.1(1) gives the Board authority to issue Guidelines "with respect to the application of" this section.[232] The Guidelines also explain that "[t]his document is intended to provide an operator … with guidance parameters and criteria for R&D [and E&T] expenditures in the Province, which are required under Section 45 of the Legislation."[233] The Guidelines go on to state:

> Research & Development [and E&T] represent one avenue whereby the exploration for, and the development and production of the petroleum resources in the Newfoundland Offshore area can make a contribution to the sustainable development of the Province. This was the vision or intent of the legislators at the time when they inserted the requirement for Research & Development and Education & Training 'in the Province' into the Atlantic Accord legislation. The petroleum resource is finite and

[227] Gosine Statement, ¶¶ 17-21; Locke Report, ¶¶ 107, 111-118.

[228] Randell Statement, ¶ 18; Locke Report, ¶ 122.

[229] Locke Report, ¶¶ 111-118, 141.

[230] *Id.*, ¶¶ 112, 117,

[231] **CE-1**, Guidelines, p. 1.

[232] See Counter Memorial, ¶ 29.

[233] **CE-1**, Guidelines, p. 1.

> exhaustible, and it is the intent of this provision of the legislation that its exploitation create a lasting economic legacy for the people of the Province. This is best achieved by building on the intellectual capacity and human resources of the Province. Achievement of this legislative intent is a key reason why some parameters or guidance are required in respect of the requirement in the Act that there be expenditures in the Province for R&D. These guidelines seek to establish such parameters.[234]

129. Hence, the Guidelines explain that they are issued under the authority of the Accord Acts. This explanation is consistent with the explanation of John Fitzgerald that the Accord Acts give the Board authority to monitor and intervene if operators fail to fulfil their obligation under the Acts to expend on R&D and E&T in the province.[235] The explanation in the Guidelines is also consistent with the comments of the current Vice-Chair of the Board, Mr. Way:

> The Board reviews Benefits Reports for compliance with Benefits Plans and the legislation. By monitoring such plans the Board is conveying that it would require a corrective action if the operator were not in compliance. In the absence of such a process, there would be no reason to monitor and the Board could not ensure that the Proponent's commitments were being met.[236]

130. The Claimants rely on a comment in the August 2002 draft of the Guidelines that "[t]hese guidelines are a first effort by the C-NOPB [Board] in this area" to argue that the Guidelines impose a new requirement.[237] However, as explained by the author of the comment, Frank Smyth, the comment merely notes the fact that the Guidelines were the first effort at more detailed requirements for R&D and E&T expenditures.[238] He goes on to confirm that "[t]he R&D Guidelines do not impose new obligations on the operators.

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[234] *Id.*, p. 1.

[235] Fitzgerald Statement, ¶ 51.

[236] Way Statement, ¶ 41.

[237] Claimants' Memorial, ¶¶ 101, 182.

[238] Smyth Statement, ¶ 45.

They merely establish a benchmark, a more precise way to measure and ensure fulfilment of already existing expenditure obligations."[239]

M. Canadian Courts Confirmed that the Guidelines Were Issued Under the Authority of, and are Consistent With, the Accord Acts

131. HMDC and Petro-Canada, the operators of the Hibernia and Terra Nova projects, respectively, challenged the Guidelines before Canadian courts. As explained by the Claimants, the operators "argued under Canadian law that the Board acted in excess of its statutory authority in promulgating the Guidelines."[240] While considering this challenge, the courts considered and interpreted the scope of the R&D and E&T expenditure obligation in the Accord Acts and Decisions 86.01 and 97.02 approving the Benefits Plans.

132. Both the Trial Court and a majority of the Court of Appeal of NL's Supreme Court rejected the challenge and confirmed that the Guidelines were issued under the authority of the Board conferred by the Accord Acts to ensure expenditures on R&D and E&T in the province. The courts held that the Guidelines were consistent with the Accord Acts and the Board decisions approving the Benefits Plans. Leave to appeal the decision of the Court of Appeal was rejected by the Supreme Court of Canada, the highest court in the country.[241]

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[239] Smyth Statement, ¶ 46.

[240] Claimants' Memorial, ¶ 121.

[241] **CA-54**, Supreme Court of Canada Decision, p. 3. The Supreme Court decides whether to hear cases based on the public importance of the issue in dispute. **RA-51**, *Supreme Court Act*, R.S.C. 1985, c. S-26, s. 40(1) ("Subject to subsection (3), an appeal lies to the Supreme Court from any final or other judgment of the Federal Court of Appeal or the highest court of final resort in a province, or a judge thereof, in which judgment can be had in the particular case sought to be appealed to the Supreme Court, whether or not leave to appeal to the Supreme Court has been refused by any other court, where, with respect to the particular case sought to be appealed, the Supreme Court is of the opinion that any question involved therein is, by reason of its public importance or the importance of any issue of law or any issue of mixed law and fact involved in that question, one that ought to be decided by the Supreme Court or is, for any other reason, of such a nature or significance as to warrant decision by it, and leave to appeal from that judgment is accordingly granted by the Supreme Court.").

133. Both the Trial and Appeal Court considered that the applications required them to consider if the Board had the authority under the Accord Acts to issue the Guidelines.[242] Both courts agreed that they were required to apply the administrative law standard of reasonableness to answer this question.[243] The Court of Appeal held that this standard required them to ask "whether the [Board's] decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law."[244] Hence, the courts asked whether it was reasonable to conclude that the Board had the authority to issue the Guidelines. Both courts concluded that it was. According to the Trial Court, "the Board's decision to establish the R&D Guidelines is a reasonable interpretation of the Accord and the Accord Acts."[245]

134. The courts also concluded that the alternative interpretation proffered by the operators – the same interpretation that the Claimants proffer in this arbitration[246] - was not reasonable. According to the Court of Appeal, "there is nothing in the [Accord] Act or the benefits plans supporting the conclusion that the company may unilaterally

[242] **CA-52**, Trial Court Decision, ¶ 13; **CA-53**, Court of Appeal Decision, ¶ 1, stating that the appeal raised "questions as to the scope of authority of the Board to interpret and apply the research and development component of the companies' benefits plans" and at ¶ 43 that "[t]he crux of the submissions by Hibernia Management and Petro-Canada regarding the Board's application of the 2004 Guidelines to their Projects is that application of the Guidelines constitutes a unilateral amendment of the prior approved benefits plans, an action which the Board is not authorized to take."

[243] **CA-52**, Trial Court Decision, ¶¶ 27, 91; **CA-53**, Court of Appeal Decision, ¶¶ 58, 124.

[244] **CA-53**, Court of Appeal Decision, ¶ 33.

[245] **CA-52**, Trial Court Decision, ¶ 56. Justice Adams also acknowledged at ¶ 83 that "the Board's decision to tie research and development expenditures to industry norms in fulfilment of its obligations to determine what would be a reasonable and sufficient level of expenditure on research and development is a reasonable approach." He also acknowledged at ¶ 89 that "it is not unreasonable ... for the Board to establish an R&D Fund to be spent in conjunction with the operators to ensure that adequate expenditures as determined by the Board are actually made in the province on research and development." See also **CA-53**, Court of Appeal Decision, ¶ 67 ("A reasonable inference flowing from the monitoring function is that the Board may determine that the expenditures of a company do not meet the requirements of the benefits plan.").

[246] Claimants' Memorial, ¶ 114.

determine the level of expenditure on research and development."[247] The court went on to say that:

> section 45(3) of the federal Act provides that a Canada-Newfoundland benefits plan shall contain provisions intended to ensure that expenditures shall be made for research and development to be carried out in the Province. These mandatory provisions contain no qualification entitling oil companies to refuse to expend on research and development because they are of the opinion the needs of their projects can be met with existing knowledge and technology.[248]

135. The Canadian courts not only concluded that the Board's *interpretation of its authority was reasonable* and that the proponents' interpretation of that authority was not reasonable, they affirmed that the Board *had the authority* under the Accord Acts to issue the Guidelines. The Trial Court concluded that the Board "has the authority to establish reasonable levels of expenditure required to be made for research and development and education and training as part of its ongoing monitoring and enforcement role under the Accord and the Act."[249] This was confirmed by the Court of Appeal.[250]

136. In their analysis, the courts also considered whether establishing those reasonable levels of R&D and E&T expenditures was consistent with the decisions approving the Benefits Plans. The Court of Appeal held that "application of the Guidelines to the Hibernia and Terra Nova Projects does not involve an amendment to the benefits plans. Rather, the Guidelines set parameters consistent with the Board's responsibility to monitor expenditures for research and development required under the benefits plans."[251]

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[247] **CA-53**, Court of Appeal Decision, Justice Welsh, ¶ 66.

[248] **CA-53**, Court of Appeal Decision, Justice Barry, ¶ 130. The emphasis is the Court's. See also **CA-53**, Court of Appeal Decision, Justice Barry, ¶¶ 131, 132; and **CA-52**, Trial Court Decision, ¶¶ 45, 46.

[249] **CA-52**, Trial Court Decision, ¶ 74. See also, ¶ 56.

[250] **CA-53**, Court of Appeal Decision, Justice Welsh, ¶ 79 ("the applications judge did not err when he concluded ... that the Board has authority to establish reasonable levels of expenditures to be made by the companies for research and development.").

[251] **CA-53**, Court of Appeal Decision, Justice Welsh, ¶ 105.

137. The Court of Appeal held that "the Board in its Decision 86.01 and its Decision 97.02 reserved for itself authority to determine on a continuing basis by its monitoring process whether the companies were making adequate expenditures on research and development."[252] It went on to say that "the reservation of authority to require more expenditures was more than implicit."[253] The Board:

> approved the Hibernia and Terra Nova projects on condition that the Board have the authority to continuously monitor research and development expenditures and intervene by issuing guidelines requiring higher expenditures should the appellants' level of expenditures fall below that which the Board considered appropriate. These were the rules of the game when development approvals [sic.] issued. The same rules apply today.[254]

138. The courts also considered whether the Board could condition the POAs on compliance with the Guidelines and concluded that it could. According to the Court of Appeal, "the authority to issue a production authorization is subject to a determination by the Board that the company is in compliance with its benefits plan. In the case of the Hibernia and Terra Nova Projects, this would include compliance with the 2004 Guidelines."[255]

139. Just as they affirmed the authority of the Board to condition the POAs on compliance with the Guidelines, the courts also affirmed the authority of the Board to establish a fund for money which was not spent on R&D and E&T in the province. According to the Court of Appeal, "[g]iven the nature and purpose of the research and development fund, I am satisfied that, in establishing and administering the fund, the

[252] **CA-53**, Court of Appeal Decision, Justice Barry, ¶ 125.

[253] **CA-53**, Court of Appeal Decision, Justice Barry, ¶ 126.

[254] **CA-53**, Court of Appeal Decision, Justice Barry, ¶ 135. See also **CA-52**, Trial Court Decision, ¶ 47.

[255] **CA-53**, Court of Appeal Decision, Justice Welsh, ¶ 107. See also Justice Welsh, ¶¶ 108-109; **CA-52**, Trial Court Decision, ¶¶ 72, 90.

Board was exercising an implied or incidental power appropriate and necessary to carrying out its mandate under the legislation."[256]

140. Consequently, the majority of the Court of Appeal agreed with the Trial Court that it was *reasonable* to conclude that the Guidelines were issued under the authority of, and are consistent with, the Accord Acts and the decisions approving the Benefits Plans. Just like the Trial Court, the majority of the Court of Appeal went further and found that:

a) the Guidelines *were* adopted under the authority of, and *are* consistent with, the Accord Acts;

b) the Guidelines *are* consistent with Decisions 86.01 and 97.02 approving the Hibernia and Terra Nova Benefits Plans;

c) the Board *did* reserve the authority to monitor expenditures on R&D and E&T and intervene if expenditures were inadequate;

d) the proponents *cannot* fulfil their R&D and E&T obligations merely by spending what was necessary for the projects;

e) conditioning POAs on compliance with the Guidelines *is* consistent with the Accord Acts and the decisions approving the Benefits Plans; and

f) establishing a fund for money not spent on R&D and E&T *is* consistent with the Accord Acts and the decisions approving the Benefits Plans.

141. On the basis of these findings, the majority concluded that "the appeal as to the Board's authority to apply the Guidelines to the Hibernia and Terra Nova projects is dismissed."[257] An application for leave to appeal the decision of the NL Court of Appeal was rejected by the Supreme Court of Canada.[258]

[256] **CA-53**, Court of Appeal Decision, Justice Welsh, ¶ 98. See also **CA-52**, Trial Court Decision, ¶ 86.

[257] **CA-53**, Court of Appeal Decision, Justice Welsh, ¶ 92.

[258] **CA-54**, Supreme Court of Canada Decision, p. 3.

III. THE GUIDELINES DO NOT BREACH ARTICLE 1106

A. Canada Has Not Violated Article 1106(1)(c) of the NAFTA

142. The Claimants allege that the Guidelines violate Article 1106(1)(c) of the NAFTA, which prohibits the imposition of certain types of performance requirements.[259] Article 1106(1)(c) states:

> No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
>
> ...
>
> (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;

143. Canada has not violated Article 1106(1)(c) by issuing the Guidelines. The claim should be dismissed because:

a) Article 1106(1)(c) does not prohibit either R&D or E&T expenditure requirements;

b) even if R&D and E&T requirements could fall within the scope of Article 1106(1)(c), and even if some R&D and E&T expenditures may involve some purchase of local goods or services, there is still no breach of Article 1106(1)(c) because the Guidelines do not necessarily compel the purchase, use or accordance of a preference to local goods or services;

c) even if, somehow, the Guidelines are inconsistent with Article 1106(1)(c), they do not breach the Article because the Accord Acts, and the Guidelines as a subordinate measure, were reserved in NAFTA Annex 1.

[259] Claimants' Memorial, ¶¶ 145-193.

1. Article 1106(1)(c) Does Not Prohibit Requirements Regarding R&D or E&T

a) Article 1106(5) Requires that Article 1106(1) Be Interpreted Restrictively

144. Article 1106(1) lists seven specific "performance requirements" that a NAFTA Party is prohibited from imposing or enforcing in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment in its territory.

145. Article 1106(5) makes it clear that the only prohibited performance requirements are those expressly set out in Article 1106(1). Article 1106(5) states:

> [Article 1106] Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

146. The Vienna Convention on the Law of Treaties ("VCLT") requires interpretation of a treaty "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."[260] The ordinary meaning of Article 1106(5) is obvious: the list of performance requirements set out in Article 1106(1) is exhaustive. Hence, a measure will not contravene that paragraph unless explicitly prohibited by Article 1106(1).

147. This position has been supported by two NAFTA tribunals - *S.D. Myers v. Canada*[261] and *Pope & Talbot v. Canada*[262] - which have examined the meaning and application of Articles 1106(1) and (5).

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[260] **CA-9**, Vienna Convention on the Law of Treaties, May 23, 1969, 1115 U.N.T.S. 331 (entered into force January 27, 1980), Article 31(1) (hereinafter "VCLT").

[261] **CA-44**, S.D. Myers Inc. v. Government of Canada, (UNCITRAL) Partial Award of November 13, 2000 (hereinafter "*S.D. Myers*").

[262] **CA-41**, Pope & Talbot Inc. v. Government of Canada, (UNCITRAL) Interim Award of June 26, 2000 (hereinafter "*Pope & Talbot*").

148. In *S.D. Myers*, the claimant argued that, in addition to a violation of Articles 1102 (national treatment), 1105 (minimum standard of treatment) and 1110 (expropriation), Canada's restriction on the export of hazardous waste amounted to a violation of Articles 1106(1)(b) and (c). The tribunal stated in its Partial Award:

> Although the Tribunal must review the substance of the measure, it cannot take into consideration any limitations or restrictions that do not fall squarely within the 'requirements' listed in Articles 1106(1) and (3).[263]

149. The tribunal in *Pope & Talbot*, which dealt with a claim by the investor that Canada's implementation of the 1996 Softwood Lumber Agreement violated various provisions of NAFTA Chapter 11, including Articles 1106(1)(a) and (e) and 1106(3)(d), echoed the finding of *S.D. Myers*:

> The Tribunal endorses Canada's contention that Article 1106(5) is vital to the interpretation of Articles 1106(1) and (3). Consequently, *the ambit of these two Articles may not be broadened beyond their express terms*. The enumeration of seven requirements in Article 1106(1) and four in Article 1106(3) is limiting in each case."[264]

150. The United States endorsed the same principle in its NAFTA Article 1128 submission[265] to the *Pope & Talbot* tribunal:

> Article 1106 identifies two categories of performance requirements and, separately for each category, sets forth an *exhaustive list* of the specific performance requirements prohibited. The Article prescribes different prohibitions for each category.
>
> ...

[263] **CA-44**, *S.D. Myers*, ¶ 275.

[264] **CA-41**, *Pope & Talbot*, ¶ 70, emphasis added. *Pope & Talbot* dealt with a claim by the investor that Canada's implementation of the 1996 Softwood Lumber Agreement ("SLA") amounted to an impermissible export quota that violated NAFTA Articles 1106(1)(a) and (e) and 1106(3)(d). None of these provisions are at issue in this arbitration.

[265] **CA-3**, NAFTA Chapter 11, Article 1128 provides: "On written notice to the disputing parties, a Party may make submissions to a Tribunal on a question of interpretation of this Agreement."

> Article 1106(5) states explicitly and clearly that Article 1106(1) applies only to the seven performance requirements specifically listed in Article 1106(1)...[266]

151. Leading commentators agree that Article 1106(5) limits the application of Article 1106(1) to the seven types of performance requirements that are expressly enumerated.[267]

152. Accordingly, when considering whether "research and development" and "education and training" expenditure requirements are covered by Article 1106(1)(c), the Tribunal is mandated by Article 1106(5) to adopt a restrictive approach and determine whether such requirements "fall squarely" and specifically into the prohibited performance requirement of purchase, use or preference for local goods or services.

153. The Claimants make no mention of Article 1106(5) in their Memorial. Instead, they make the broad and unsupported contention that "there can be no question that a requirement to undertake R&D expenditures in the Province in excess of what investors

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[266] **RA-41**, *Pope & Talbot Inc. v. Government of Canada*, (UNCITRAL) Submission of the United States of America, April 7, 2000, ¶¶ 9, 12, emphasis added.

[267] **RA-21**, J. Johnson, *The North American Free Trade Agreement: A Comprehensive Guide* (Ontario: Canada Law Book Inc., 1994), pp. 287-88 ("NAFTA 1106(5) makes it clear that the prohibited performance requirements, whether as conditions of investment or receiving an advantage, are *confined to those specifically identified*") (emphasis added); **CA-59**, Meg N. Kinnear et al., *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006), p. 16-1106 (hereinafter "Kinnear") ("NAFTA 1106(5) states what should be obvious from the wording of Article 1106(1) and 1106(3): *only those performance requirements that are specifically listed in Article 1106 are prohibited under this article*") (emphasis added); **RA-72**, Kenneth J. Vandevelde, *U.S. International Investment Agreements* (Oxford: 2009), p. 404 (hereinafter "Vandevelde") ("Article 1106(5) of NAFTA provides that the prohibitions in Articles 1106(1) and 1106(3) do not apply to any requirement other than the requirements set out in those paragraphs. In other words, *the list of prohibited performance requirements is exhaustive*") (emphasis added); **RA-73**, J. Anthony VanDuzer, *NAFTA Chapter 11 to Date: The Progress of a Work in Progress*, in L. Dawson, ed., *Whose Rights: The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law, 2002), p. 75 ("Article 1106(5) states that the prohibitions in Article 1106(1) are not to be interpreted to extend beyond those requirements specifically listed and the *S.D. Myers* and *Pope & Talbot* tribunals have interpreted the provisions in a manner that is consistent with this admonition"). Co-counsel for the Claimants has also written that Article 1106(1) contains the "definitive list" of prohibited performance requirements. **CA-61**, Barton Legum, *Understanding Performance Requirement Prohibitions in Investment Treaties*, in *Contemporary Issues in International Arbitration and Mediation*, p. 59 (Jun. 2007) ("The NAFTA provides a *definitive* list of prohibited performance requirements rather than a series of examples. In the first paragraph, NAFTA Article 1106 lists seven *specific* types of host State measures that the State cannot impose or enforce.") (emphasis added).

would otherwise spend constitutes a performance requirement within the meaning of Article 1106(1)."[268]

154. The Claimants fail to acknowledge that not *all* types of performance requirements are prohibited by NAFTA. Only those requirements set out specifically in Article 1106(1) are prohibited. The text of Article 1106(1)(c) does not contain reference to R&D or E&T requirements. Further, as set out below, when understood in their economic policy context and in the context of NAFTA and other international treaties, it is clear that R&D and E&T expenditures do not fall within the ambit of Article 1106(1)(c).

b) Article 1106(1)(c) Does Not Encompass R&D or E&T Performance Requirements

i) There is No Reference to R&D or E&T in Article 1106(1)(c)

155. The Claimants argue that by requiring expenditures on R&D in the province, the Guidelines impose requirements contrary to Article 1106(1)(c).[269] The Claimants make no specific complaint in the Memorial with respect to E&T expenditures as a prohibited performance requirement. Instead, as explained further below, Claimants incorrectly treat R&D and E&T expenditures under the Guidelines as one and the same.[270]

156. The Claimants' understanding of Article 1106(1)(c) is mistaken. In order for an impugned measure to violate Article 1106(1)(c), it must:

- impose a requirement;
- in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party;

[268] Claimants' Memorial, ¶ 151.

[269] Claimants' Memorial, ¶¶ 145-161.

[270] Claimants' Memorial, ¶ 108, fn. 201. As set out further below, the differences between the two categories of expenditures cannot be ignored, as the Claimants do, because of their different economic policy goals, as well as the fact that various types of R&D and E&T expenditures do not necessarily compel the purchase, use or preference for local goods or services, and hence cannot be in violation of Article 1106(1)(c).

- to purchase, use or accord a preference to domestic goods or services.

157. There is no mention of either "research and development" or "education and training" in Article 1106(1)(c). Since Article 1106(1) must be interpreted restrictively and "may not be broadened beyond [its] express terms,"[271] as a threshold matter, it cannot be presumed, as the Claimants do, that a requirement for an investor to conduct or support R&D or E&T falls within the scope of Article 1106(1)(c).

158. The Claimants' attempt to shoehorn R&D expenditures into Article 1106(1)(c) goes beyond the limited scope of that provision. As set out below, a requirement to conduct or support R&D is a different type of performance requirement from the requirement to purchase or use local goods or services, which is what Article 1106(1)(c) is intended to preclude.

159. Similarly, there is no mention of E&T in Article 1106(1) because that type of performance requirement is not covered by the definitive list of seven performance requirements set out in Article 1106(1). Not only are the Claimants wrong to presume that R&D and E&T are one and the same (they are not), but as explained below,[272] the distinction between R&D and E&T requirements is key to understanding why the Guidelines do not impose a requirement to make expenditures prohibited by Article 1106(1).

ii) R&D and E&T Are Distinct Types of Performance Requirements

160. Performance requirements can be generally defined as "stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country."[273] Such requirements may be imposed by a host country in

[271] **CA-41**, *Pope & Talbot*, ¶ 70.

[272] Counter Memorial, ¶¶ 186-202.

[273] **RA-67**, UNCTAD, *Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries*, UNCTAD/ITE/IIA/2003/7, p. 2 (hereinafter "Foreign Direct Investment and Performance Requirements").

connection with the establishment and operation of the investment (mandatory) and/or in exchange for the granting of a particular advantage (conditional).[274]

161. There is a wide array of possible performance requirements that a host State may impose on foreign investors. Many are described in various reports by the United Nations Conference on Trade & Development ("UNCTAD") relied on by the Claimants.[275] However, the Claimants have overlooked the distinction UNCTAD draws between various types of performance requirements, including local content, R&D and E&T.

162. In a survey of various types of performance requirements (referred to by UNCTAD as "host country operational measures" or "HCOMs"[276]), UNCTAD treats "sourcing/local content performance requirements" (which are covered by NAFTA Article 1106(1)(c)) differently from "research and development requirements" and "training requirements."[277] UNCTAD notes that local content requirements for the

[274] *Id.*; **RA-68**, UNCTAD, *Host Country Operational Measures* (UNCTAD/ITE/IIT/26: 2001), p. 11 (hereinafter "Host Country Operational Measures").

[275] Claimants' Memorial, ¶¶ 147, 152. UNCTAD, the focal point in the United Nations Secretariat for issues relating to foreign direct investments, made a list of thirty nine different types of performance requirements that it had observed. **RA-68**, Host Country Operational Measures, pp. 8-9. Economic literature is not conclusive on whether, depending on the circumstances, certain types of performance requirements are helpful, harmful or neutral to host States and foreign investors. See **RA-48**, M. Sornarajah, *The International Law on Foreign Investment*, 2nd ed. (Cambridge: 2004), p. 238; **RA-67**, Foreign Direct Investment and Performance Requirements, p. 2 ("There are divergent views as regards the effectiveness of performance requirements to achieve [development objectives]. While some experts regard them as an essential instrument in a country's FDI policy package, others tend to argue that their impact on investments is at best limited and at worst costly and counter-productive."); **RA-68**, Host Country Operational Measures, p. 59 ("...a review of the empirical evidence on the use of some HCOMs – especially TRIMS – allows at least some considerations that can help structure the policy options open to host Governments. It suggests that the outcome from such measures cannot be assumed to be automatically undesirable or distortionary. In other words, public sector intervention can either have a positive impact on national development, or, if carried out improperly, worsen the situation rather than improve it.").

[276] UNCTAD uses the term HCOM to cover "the vast array of measures implemented by host countries concerning the operation of foreign affiliates once inside their jurisdictions. HCOMs can cover all aspects of investment...and usually take the form of either restrictions or performance requirements. They are usually adopted to influence the location and character of foreign direct investment (FDI) and, in particular, to increase its benefits in light of national objectives." **RA-68**, Host Country Operational Measures, p. 1.

[277] **RA-68**, Host Country Operational Measures, p. 9.

purchase of goods are covered by the World Trade Organization ("WTO") Agreement on Trade Related Investment Measures ("TRIMS").[278] The TRIMS *Illustrative List* of measures prohibited by the General Agreement on Tariffs and Trade ("GATT") provides examples of measures inconsistent with the national treatment provision of the GATT and includes the same type of prohibition set out in NAFTA Article 1106(1)(c):

> Purchase or use by an enterprise of products of domestic origin or from any domestic source...[279]

163. UNCTAD refers to local content requirements as a "Red Light" HCOM because they are precluded by the TRIMS Agreement.[280]

164. In contrast, UNCTAD observes that R&D requirements are not specifically encompassed by the TRIMS Agreement and are only precluded by a limited number of bilateral or regional trade and investment treaties (such as the United States-Trinidad and Tobago BIT and the United States-Bolivia BIT, discussed below).[281] R&D requirements are classified by UNCTAD as "Yellow Light" HCOMs because they are not prohibited by TRIMS but are covered by a few bilateral or regional agreements.[282]

165. Indeed, UNCTAD has observed that the NAFTA does *not* preclude R&D performance requirements as a condition to the entry or operation of a foreign investment. Discussing performance requirements in its publication *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*,[283]

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[278] **RA-52**, World Trade Organization ("WTO"), Agreement on Trade Related Investment Measures (1994) (hereinafter "TRIMS Agreement") (1994) published in *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (Cambridge University Press, 2004), pp. 143-146. As an annex to the GATT, the TRIMS agreement deals with investment measures related to trade in goods.

[279] **RA-52**, TRIMS Agreement, Illustrative List, p. 143.

[280] **RA-68**, Host Country Operational Measures, pp. 3, 12.

[281] *Id.*, pp. 12-13, 35.

[282] *Id.*, pp. 3, 12-13, 35.

[283] **RA-69**, UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D* (New York and Geneva: United Nations, 2005) (hereinafter "World Investment Report 2005").

UNCTAD writes that NAFTA takes a different approach to R&D than some United States and Japan bilateral investment treaties which prohibit R&D requirements as a condition for entry or operation of an investment:

> *A different approach has been taken by NAFTA, where there is no prohibition of performance requirements attached to the entry and operation of FDI that mandate R&D activities in the territory of the host country (Article 1106(1)).* Moreover, NAFTA explicitly allows their use as a condition for the receipt or continued receipt of an advantage (Article 1106(4)). *This approach implies that countries are free to attach conditions to the entry and operation of investments in the form of mandatory involvement in R&D activities, provided other core disciplines of the applicable agreements (such as national treatment, MFN, protection against expropriation) are adhered to.* It also implies that countries are specifically allowed to apply such conditions by attaching them to an incentive.[284]

166. UNCTAD goes on to observe that other investment treaties follow the NAFTA approach and do not prohibit the use of R&D performance requirements.[285]

167. Training is also considered to be a distinct type of performance requirement utilized by governments to promote local employment and long-term skills development: "the purpose [of training] may be to address various imbalances in the labour market, to induce firms to engage more actively in training and human resource development activities and/or to encourage the expansion of certain skill-intensive functions."[286] UNCTAD lists "training requirements" as a separate type of performance requirement from both local content and R&D and classifies them as a "Green Light" HCOM because they are generally not subject to control by international treaties.[287] The fact that the Guidelines have the additional element of "education" serves to distinguish the E&T

[284] *Id.*, p. 229, emphasis added.

[285] *Id.*

[286] **RA-67**, Foreign Direct Investment and Performance Requirements, p. 30.

[287] **RA-68**, Host Country Operational Measures, pp. 2-3, 9; **RA-67**, Foreign Direct Investment and Performance Requirements, p. 4, fn. 6 ("Training requirements are not restricted in [international investment agreements].").

aspect of the Guidelines even further from the local content type of requirement covered by Article 1106(1)(c).

168. The distinction between a requirement to purchase local goods or services and requirements to conduct R&D or E&T is understandable from an economic policy perspective. R&D and E&T requirements serve different policy goals than requirements to purchase, use or accord a preference to local goods or services. UNCTAD describes the objective of R&D performance requirements as follows:

> R&D activities tend to be among the forms of FDI projects most sought by investment promotion agencies. Imposing an R&D requirement – either mandatory or voluntary – is one approach that has been used by policy makers in various countries in order to maximize benefits from FDI. For example, efforts by developed countries to impose local R&D requirements as a condition of entry have been used to address concerns that excessive reliance on FDI could limit technological development, since R&D was perceived to be largely concentrated in home countries, notably in the case of TNCs from the United States and Japan.[288]

169. The underlying economic rationale for R&D requirements is different than that for local content requirements. R&D requirements are not aimed at reducing imports or providing a guaranteed domestic market to local producers of goods or services. Rather, they are aimed at strengthening the knowledge capacity of the host State and allowing for spin-off benefits whereby R&D in one area can help develop and spill-over into other sectors of the economy (for example, in high technology).[289] The benefits of R&D tend to yield high value added in terms of skills training and technology,[290] and there is evidence that suggests a direct relationship between R&D and economic growth.[291]

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[288] **RA-67**, Foreign Direct Investment and Performance Requirements, p. 28.

[289] **RA-69**, World Investment Report 2005, p. 181-190.

[290] *Id.*, p. 109.

[291] *Id.*, p. 103. See also **RA-75**, World Trade Organization, "Report (1998) of the Working Group on the Relationship Between Trade and Investment to the General Council," WT/WGTI/2 (8 December 1998), p. 28, ¶ 98 ("performance requirements relating to...the promotion of research and development...generally had been shown to have positive effects.") (hereinafter "WTO Working Group Report (1998)").

170. Indeed, conducting R&D and supporting E&T in the host country are part of the mechanisms used to promote sustainable development,[292] one of the express goals set out in the Preamble of the NAFTA.[293] The Report of the United Nations Conference of Environment and Development (commonly known as the "Rio Declaration") describes the growth of local scientific capacity as an essential part of sustainable development and encourages States to "cooperate to strengthen endogenous capacity-building for sustainable development by improving scientific understanding through exchanges of scientific and technological knowledge, and by enhancing the development, adaption, diffusion and transfer of technologies, including new innovative technologies."[294] Leading economic and trade organizations such as the WTO and Organization for Economic Cooperation and Development ("OECD") have recognized and encouraged local R&D as a valid tool for development. The WTO has observed that "the promotion of research and development had been demonstrated to be an effective instrument of the development policies of host countries."[295] The OECD for its part encourages multi-national corporations to conduct R&D and training activities in host states in cooperation with local actors because such activities "can help enhance the economic and social progress."[296]

171. In sum, performance requirements are mechanisms of economic policy and have important distinctions that lead both developed and developing countries to choose to

[292] The World Commission on the Environment and Development, commonly known as the "Brundtland Commission," describes sustainable development as "development that meets the needs of the present, without compromising the ability of future generations to meet their own needs." **RA-53**, United Nations, Report of the World Commission on Environment and Development (Aug. 4, 1987) (U.N. General Assembly Doc. A/42/427) (hereinafter "Report of the World Commission on Environment and Development"), ¶ 1.

[293] **RA-30**, The NAFTA Preamble states that the parties have resolved to "promote sustainable development."

[294] **RA-43**, United Nations General Assembly, The Rio Declaration: Report of the United Nations Conference of Environment and Development, A/CONF. 151/26 (Vol. I) (1992), Principle 9.

[295] **RA-75**, WTO Working Group Report (1998), p. 20, ¶ 68.

[296] **RA-37**, The OECD Guidelines for Multinational Corporations: Text, Commentary and Clarifications, OECD, pp. 50-51.

forgo some and embrace others, depending on the economic context in which they are imposed. Some are prohibited by treaty, others are not. The distinctions between local content requirements and R&D and E&T requirements cannot be ignored in the context of Article 1106, and compels the conclusion that they are not covered by Article 1106(1)(c), especially in light of Article 1106(5).

iii) Where States Have Wanted to Prohibit R&D and E&T Requirements, They Have Done So Explicitly

(a) United States and Other States BIT Practice

172. A review of the treaty practice by other countries with respect to performance requirements, including the United States, further confirms the conclusion that R&D and E&T requirements are not the same as a requirement to purchase or use local goods or services.

173. Recent BIT practice by the United States confirms the distinction between R&D requirements and requirements to purchase, use, or afford a preference to local goods or services. Article 6 of the 1994 U.S. Prototype BIT ("1994 Model U.S. BIT") contains the following language:

> Neither Party shall mandate or enforce...any requirement...
>
> (a) to achieve a particular level or percentage of local content, or *to purchase, use or otherwise give a preference to products or services of domestic origin or from any domestic source;*
>
> (b) to limit imports by the investment of products or services in relation to a particular volume or value of production, exports or foreign exchange earnings;
>
> (c) to export a particular type, level or percentage of products or services, either generally or to a specific market region;
>
> (d) to limit sales by the investment of products or services in the Party's territory in relation to a particular volume or value of production, exports or foreign exchange earnings;

> (e) to transfer technology, a production process or other proprietary knowledge to a national or company in the Party's territory, except pursuant to an order, commitment or undertaking that is enforced by a court, administrative tribunal or competition authority to remedy an alleged or adjudicated violation of competition laws; or
>
> *(f) to carry out a particular type or percentage of research and development in the Party's territory.* [297]

174. The language from the 1994 Model U.S. BIT, which was developed at the same time as the NAFTA, is replicated in the performance requirement provisions in thirteen

[297] **RA-72**, 1994 Model Treaty Between the Government of the United States of America and The Government of [___] Concerning the Encouragement and Reciprocal Protection of Investment, published in Vandevelde, pp. 817-824, emphasis added (hereinafter "1994 U.S. Model BIT"). Vandevelde notes that "The 1994 model differs from the prior models in that it defines more precisely the prohibited performance requirements. Prior models had prohibited certain specified requirements and "any other similar requirements." The quoted language was omitted from the 1994 draft, with the result that only those performance requirements expressly identified in the provision are prohibited. Other requirements that may be "similar" are not." **RA-72**, Vandevelde, p. 389.

U.S. BITs.[298] If the requirement to purchase or use local goods or services was the same as R&D requirements, there would have been no need to make a distinction between the two in those treaties.[299]

[298] **RA-54**, Treaty Between the Government of the United States of America and the Government of the Republic of Albania Concerning the Encouragement and Reciprocal Protection of Investment, signed at Washington January 11, 1995, entered into force January 4, 1998, Article VI (a) and (f); **RA-55**, Treaty Between the Government of the United States of America and the Government of the Republic of Azerbaijan Concerning the Encouragement and Reciprocal Protection of Investment, signed at Washington August 1, 1997, entered into force August 2, 2001, Article VI (a) and (f); **RA-56**, Treaty Between the Government of the United States of America and the State of Bahrain Concerning the Encouragement and Reciprocal Protection of Investment, signed at Washington September 29, 1999, entered into force May 31, 2001, Article 6 (a) and (f); **RA-57**, Treaty Between the Government of the United States of America and the Government of the Republic of Bolivia Concerning the Encouragement and Reciprocal Protection of Investment, signed at Santiago, Chile April 17, 1998, entered into force June 6, 2001, Article VI (a) and (f); **RA-58**, Treaty Between the Government of the United States of America and the Government of the Republic of Croatia Concerning the Encouragement and Reciprocal Protection of Investment, signed at Zagreb July 13, 1996, entered into force June 20, 2001, Article VII (a) and (f); **RA-59**, Treaty Between the Government of the United States of America and the Government of the Republic of El Salvador Concerning the Encouragement and Reciprocal Protection of Investment, signed at San Salvador, March 10, 1999, Article VI (a) and (f); **RA-60**, Treaty Between the Government of the United States of America and the Government of the Republic of Georgia Concerning the Encouragement and Reciprocal Protection of Investment, signed at Washington March 7, 1994, entered into force August 17, 1997, Article VI (a) and (f); **RA-61**, Treaty Between the Government of the United States of America and the Government of the Republic of Honduras Concerning the Encouragement and Reciprocal Protection of Investment, signed at Denver July 1, 1995, entered into force July 11, 2001, Article VI (a) and (f); **RA-62**, Treaty Between the Government of the United States of America and the Government of the Hashemite Kingdom of Jordan Concerning the Encouragement and Reciprocal Protection of Investment, signed at Amman July 2, 1997, entered into force June 13, 2003, Article VI (a) and (f); **RA-63**, Treaty Between the Government of the United States of America and the Government of the Republic of Mozambique Concerning the Encouragement and Reciprocal Protection of Investment, signed at Washington December 1, 1998, entered into force March 3, 2005, Article VI (a) and (f); **RA-64**, Treaty Between the Government of the United States of America and the Government of the Republic of Nicaragua Concerning the Encouragement and Reciprocal Protection of Investment, signed at Denver July 1, 1995, Article VI.1 (a) and (f); **RA-65**, Treaty Between the United States of America and the Government of the Republic of Trinidad and Tobago Concerning the Encouragement and Reciprocal Protection of Investment, signed at Washington September 26, 1994, entered into force December 26, 1996, Article VI.1 (a) and (f); and **RA-66**, Treaty Between the Government of the United States of America and the Government of the Republic of Uzbekistan Concerning the Encouragement and Reciprocal Protection of Investment, signed at Washington, December 16, 1994, Article VI (a) and (f).

[299] The 2004 U.S. Model BIT refined the performance requirement provision from the 1994 U.S. Model BIT to adopt the more complex structure of NAFTA Article 1106. Like NAFTA Article 1106, Article 8(2) of the 2004 U.S. Model BIT contains no prohibition on requirements to perform R&D in the host State as a condition of establishment or operation of an investment. According to Professor Vandevelde, the United States apparently removed the prohibition against R&D requirements that existed in Article 6(f) of the 1994 Model U.S BIT because it was concerned that its own domestic practice was inconsistent with that prohibition. **RA-72**, Vandevelde, p. 393. Vandevelde also notes that Article 8(4) of the 2004 Model BIT serves the same purpose as NAFTA Article 1106(5): to make "explicit" that "the list of prohibited performance requirements is exhaustive." **RA-72**, Vandevelde, p. 391.

175. Japan has taken a similar approach in several of its BITs and other trade agreements.[300] These treaties make the same distinction between a requirement to purchase local goods or services from a requirement to undertake R&D, both of which are specifically enumerated as prohibited requirements, except when connected with an incentive.

176. The BIT practice of the United States and Japan, whose corporations are many of the world's most important sources of R&D,[301] serve to illustrate that local content and R&D and E&T performance requirements are not the same and should not be treated as such when applying Article 1106(1)(c). If the parties to these treaties understood R&D to be the same performance requirement as the requirement to purchase or use local goods or services, there would be no need to specifically enumerate R&D as a separate category.

[300] **RA-23**, Agreement Between the Government of the Republic of Korea and the Government of Japan For the Liberalisation, Promotion and Protection of Investment, signed at Seoul, March 22, 2002, entered into force January 1, 2003, Article 9(1)(c) and (h) ("Neither Contracting Party shall impose or enforce, as a condition for investment and business activities in its territory of an investor of the other Contracting Party, any of the following requirements: ... (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from natural or legal persons or any other entity in its territory; ... (h) to achieve a given level or value of research and development in its territory; ..."); **RA-74**, Agreement Between the Government of the Republic of Vietnam and the Government of Japan For the Liberalisation, Promotion and Protection of Investment, signed at Tokyo, November 14, 2003, Article 4(1)(c) and (i) ("Neither Contracting Party shall impose or enforce, as a condition for investment activities in its Area of an investor of the other Contracting Party, any of the following requirements: ... (c) to purchase, use or accord a preference to goods produced or services provided in its Area, or to purchase goods or services from natural or legal persons or any other entity in its Area; ... (i) to achieve a given level or value of research and development in its Area; ..."); **RA-18**, Agreement Between Japan and the Lao People's Democratic Republic for the Liberalization, Promotion and Protection of Investment, signed at Tokyo, January 16, 1998, Articles 7 (1) (c) and (j); **RA-20**, Agreement between Japan and the Republic of Uzbekistan for the Liberalization, Promotion and Protection of Investment, signed at Tashkent, August 15, 2008, Article 5 (1) (c) and (k) ("Neither Contracting Party shall impose or enforce, as a condition for investment activities in its Area of an investor of the other Contracting Party, any of the following requirements: ... (c) to purchase, use or accord a preference to goods produced or services provided in its Area, or to purchase goods or services from natural or legal persons or any other entity in its Area ... (k) to achieve a given level or value of research and development in its Area; ..."); **RA-19**, Agreement Between Japan and the Republic of Singapore for a New-Age Economic Partnership, signed at Singapore, January 13, 2002, Article 75 (1) (c) and (h).

[301] **RA-69**, World Investment Report 2005, p. 105.

(b) Multilateral Agreement on Investment

177. The last negotiating draft of the Multilateral Agreement on Investment ("MAI") also made the distinction between R&D and the requirement to purchase or use local goods or services. The MAI draft article entitled "Performance Requirements" stated:

> A Contracting Party shall not...impose, enforce or maintain any of the following requirements, or enforce any commitment or undertaking
>
> ...
>
> (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
>
> ...
>
> (i) to achieve a given level or value of research and development in its territory;[302]

178. As in the case of the U.S. and Japanese BITs, if the dozens of MAI negotiating parties understood R&D to be the same type of performance requirement as the requirement to purchase or use local goods or services, there would have been no need to specifically enumerate R&D as a separate category from the purchase, use or preference for local goods or services.

(c) Conclusion

179. The above review of policy documents and international legal instruments serve to illustrate that there is a generally understood distinction between a requirement to purchase local goods or services and a requirement to achieve a certain level or value of

[302] **RA-36**, The Multilateral Agreement on Investment: Draft Consolidated Text, (DAFFE/MAI(98)/REV1, April 22, 1998), pp. 18, 19, 21, internal citations omitted. As noted in the last negotiating draft of the MAI, several countries were opposed or non-committal to the inclusion of the R&D performance requirement in the MAI's list of prohibited performance requirements. *Id.*, p. 21. See also **RA-75**, WTO Working Group Report (1998), p. 15, ¶ 42 ("[T]he view was expressed that the rationale of the prohibitions contained in several existing investment agreements and in the draft [MAI] of performance requirements related to the terms of transfer of technology and the promotion of research and development activities in host countries was questionable.").

R&D and E&T. Put simply, they are different types of performance requirements. The former type was included in the definitive list of seven prohibited requirements in Article 1106(1). The latter types were not. Given the discipline imposed by Article 1106(5) that specifically says Article 1106(1) only applies to those performance requirements set out therein, R&D and E&T performance requirements do not fall within the rubric of Article 1106(1)(c).

iv) Canada-United States Free Trade Agreement Further Confirms That R&D Requirements Are Not Prohibited by NAFTA Article 1106(1)

180. Examination of the performance requirements provision of NAFTA's predecessor treaty, the Canada-U.S. Free Trade Agreement ("CUSFTA"), further confirms that R&D requirements are considered a distinct type of requirement from a requirement to purchase or use local goods or services. The predecessor to NAFTA Article 1106(1)(c) was found at CUSFTA Article 1603(1)(c), and the operative language of the two provisions, which prohibit requirements to purchase local goods or services as a condition of entry and operation of an investment, are very similar.[303] In its official synopsis of the provision, Canada considered R&D requirements to fall outside the scope of CUSFTA Article 1603(1). Canada set out its interpretation of CUSFTA Article 1603 as follows:

> Both countries have agreed to prohibit investment-related performance requirements (such as *local content* and import substitution requirements), which significantly distort bilateral trade flows. The negotiation of product mandate, *research and development*, and technology transfer requirements with investors, however, *will not be precluded*. Moreover, this Article does not

[303] **RA-9**, CUSFTA Article 1603(1)(c) states: "Neither Party shall impose on an investor of the other Party, as a term or condition of permitting an investment in its territory, or in connection with the regulation of the conduct or operation of a business enterprise located in its territory, a requirement to: ... purchase goods or services used by the investor in the territory of such Party or from suppliers located in such territory or accord a preference to goods or services produced in such territory."

> preclude the negotiation of performance requirements attached to subsidies or government procurement.[304]

181. The NAFTA adopts the same "closed list" model as CUSFTA Article 1603(1) but the number of precluded performance requirements set out in NAFTA Article 1106(1) was expanded from four to seven.[305] The local content prohibition in CUSFTA Article 1603(1)(c) was carried over to NAFTA Article 1106(1)(c), with slightly modified language. Two of the three performance requirements that were described as permissible under CUSFTA Article 1603 – technology transfer and product mandate – were also incorporated into NAFTA as Article 1106(1) (f) and (g), respectively, as prohibited performance requirements.[306] NAFTA Article 1106(5) was adopted to make clear that Article 1106(1) only applied to the specific list of seven performance requirements and not any other types of requirements.

182. In contrast, R&D was *not* added to the list of performance requirements prohibited by the NAFTA. Given Canada's understanding that R&D was outside the

[304] **RA-9**, CUSFTA, *Synopsis*, Copy 10.12.87, reprinted in J.D. Richard and R.G. Dearden, *The Canada-U.S. Free Trade Agreement: Final Text and Analysis,* (CCH Canadian Limited, 1988), p. 375, emphasis added. See also **RA-10**, CUSFTA, *Summary - Elaborations and Clarifications to the Elements of the Agreement As Reflected in the Legal Text of the Free Trade Agreement between Canada and the United States of America*, Copy 10.12.87, reprinted in *id.*, p. 407 ("Article 1603: Performance Requirements. 1603 proscribes the imposition of significantly trade distorting performance requirements. It does not limit Canada's ability to negotiate local employment, product mandate, technology transfer, or *research and development* undertakings with investors. Moreover, there are no restrictions on the use of performance requirements related to subsidies or government procurement") (emphasis added); **RA-22**, Jon R. Johnson & Joel S. Schachter, *The Free Trade Agreement: A Comprehensive Guide*, (Canada Law Book: 1988), p. 102 ("Only those performance requirements listed in FTA 1603.1(a) to (d) are prohibited. The Parties can continue to impose other performance requirements such as product mandate, *research and development*, and technology requirements") (emphasis added).

[305] Unlike the "illustrative list" approach of the TRIMs, which only applies to goods, NAFTA Article 1106 adopts a "closed list" model for goods and services that sets out the exhaustive list of prohibited requirements. The TRIMs text specifies that performance requirements that violate GATT Article III (national treatment) and Article XI (elimination of quantitative restrictions) are prohibited, and the illustrative list includes, like NAFTA Article 1106(1)(c), a prohibition against requirements or preferences for local sourcing.

[306] **CA-3**, Article 1106 (1) (f) and (g) state: "No party may impose or enforce any [requirement] ... (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market."

ambit of CUSFTA Article 1603(1) when connected with the establishment and operation of an investment, the same reasoning applies to Article 1106(1).

2. The Guidelines Do Not Impose or Enforce Performance Requirements Prohibited by Article 1106(1)(c)

183. Even if R&D and E&T requirements could fall within the scope of Article 1106(1)(c), which they do not, and even if some R&D and E&T expenditures may involve some purchase of local goods or services, there is still no breach of Article 1106(1)(c) because the Guidelines do not necessarily compel the purchase, use or accordance of a preference to local goods or services.

a) Article 1106(1) Requires That Investors Be Compelled to Undertake a Prohibited Performance Requirement

184. For a measure to breach Article 1106(1)(c), a party must impose or enforce a prohibited requirement or enforce a prohibited commitment or undertaking. The ordinary meaning of these words implies the notion of compulsion. The *New Shorter Oxford English Dictionary* defines "impose" as "lay or inflict (a tax, duty, charge, obligation, etc.) esp. forcibly; compel compliance with." The definition of "enforce" is "compel the occurrence or performance of." "Requirement" is defined as "something called for or demanded; a condition which must be complied." The definition of commitment is "the action of committing oneself or another to a course of action." The definition of "undertaking" is "a pledge, promise; a guarantee."[307]

185. Thus, the ordinary meaning of the phrase to "impose a requirement" is to compel something.[308] Accordingly, if an impugned measure allows an investor the option of

[307] **RA-47**, *The New Shorter Oxford Dictionary*, 5th ed., Vols. 1 and 2, *s.v.*, "impose," "enforce," "commitment," "requirement" and "undertaking."

[308] Even a measure which *deters* an action is not equivalent to a measure which *requires* an action. See **CA-41**, *Pope & Talbot*, ¶ 75 ("...the Tribunal concludes that the Investor has not made out a valid claim under Article 1106(1)(a) because the Regime does not 'impose or enforce...requirements.' Rather, it is a tariff-rate export restraint regime fixing only the level up to which covered products may be exported fee-free (EB), then at a lower fee (LFB) up to a given higher level, and thereafter in unlimited quantities at a higher fee (UFB)...*While the Regime undoubtedly deters increased exports to the U.S., that deterrence is not a 'requirement'* for establishing, acquiring, expanding, managing, conducting or operating a foreign owned business in Canada") (emphasis added).

making an expenditure on something that is *not* prohibited, then there is no compulsion to make a prohibited expenditure and, hence, no breach.

b) Not All Eligible Expenditures Under the Guidelines Necessarily Require the Purchase, Use or Accordance of a Preference to Local Goods or Services

186. The Claimants intentionally gloss over the details of the expenditure requirements under the Guidelines. The reality is that the Guidelines do not necessarily compel the purchase, use or preference for local goods or services. In fact, the Guidelines do not even necessarily require the Claimants to undertake R&D because the Claimants may fulfil their obligations exclusively through expenditures on E&T,[309] a category of performance requirement which has not been specifically addressed or challenged by the Claimants.[310] The Guidelines are broad and flexible enough to allow the Claimants to make qualifying expenditures that do not necessarily require the purchase or use of local goods or services.

187. The Guidelines are divided into four sections: Legislation (Section 1), Required Expenditure Commitments (Section 2), Eligibility Criteria (Section 3) and Administrative Criteria and Expenditure Management (Section 4).

188. Section 1 of the Guidelines sets out the legislative basis for the Board's authority to implement the Guidelines. Section 2 of the Guidelines sets out the formula to be applied to determine the level of expenditures required each year:

> R&D expenditures in the development phase of projects tend to focus primarily on education and training activities, whereas it is

[309] Smyth Statement, ¶ 41.

[310] As noted above, the Claimants treat R&D and E&T as the same requirement in their Memorial. See Claimants' Memorial, ¶ 108, fn. 201. This is a curious position given that both HMDC and Petro-Canada have reported their R&D and E&T expenditures separately, which indicates that the Claimants understood that these are distinct types of obligations under the Accord Acts. See, for example, **CE-62**, Hibernia 1986 Benefits Report; **CE-63**, Hibernia 1987 Benefits Report; **CE-66**, Hibernia 1988 Benefits Report; **CE-68**, Hibernia 1989 Benefits Report; and **CE-81**, Terra Nova 1998 R&D Report; **CE-82**, Terra Nova 1998 E&T Report; **CE-84**, Terra Nova 1999 R&D Report; **CE-85**, Terra Nova 1999 E&T Report; **CE-87**, Terra Nova 2000 R&D Report; and **CE-88**, Terra Nova 2000 E&T Report.

> expected that in the production phase there will tend to be more focus on research & development activities. *Both will be legitimate and eligible expenditures in either phase of a project. Further an operator, or group of operators, may propose an R&D program in lieu of the requirement of the guidelines.* The acceptability of such a proposal will be assessed by the Board.[311]

189. Section 2.0 of the Guidelines make two things clear. First, *either* R&D or E&T activities are acceptable. Second, proponents have the option of presenting other ideas to the Board and are not necessarily limited to the activities set out in Section 3 of the Guidelines.[312]

190. Section 3 of the Guidelines is crucial because it sets out the different types of eligible expenditures. A plain reading of Part 3 shows clearly the Guidelines do not necessarily compel the Claimants to make expenditures prohibited by Article 1106(1)(c).

191. Section 3.0 is entitled "Eligibility Criteria" and states:

> The Board seeks a definition of R&D that is reasonable and consistent with that contemplated by the Legislation. *The definitions suggested below are not considered exhaustive, and the Board will consider other reasonable areas of expenditure proposed by an operator as appropriate, on a case-by-case basis.*[313]

192. Section 3.3 of the Guidelines is entitled "Research and Development." It states:

> For the purposes of these guidelines R&D *may* include
>
> - R&D activity in the Province
>
> - Increased R&D capacity in the Province

[311] **CE-1**, Guidelines, s. 2.0, emphasis added.

[312] Smyth Statement, ¶¶ 38, 44.

[313] Emphasis added.

> *- Education & Training activity/capacity in the Province as discussed in 3.4 below.*[314]

193. Section 3.4 of the Guidelines is entitled "Education and Training." It states:

> For the purposes of these guidelines the definition of education and training in the Province, as contemplated in Section 45 of the Legislation, *shall* include expenditures for any or all of the following:
>
> - Support for the establishment and/or maintenance of education and training infrastructure
>
> - Support for technology transfer or including the advancement of trades training
>
> - Support for Chairs and Fellowships
>
> - Scholarships and work terms including provincial residents who may study or work outside the Province.[315]

194. The R&D Work Expenditure Application Form attached to the Guidelines, which must be submitted by a proponent when seeking approval of the Board for eligibility,[316] further clarifies the types of eligible expenditures. Under the heading "Classification of R&D," there are the following categories:

- Engineering;
- Design;
- Operation Research;
- Mathematical Analysis;
- Computer Programming;
- Testing or Psychological Research;

[314] Emphasis added.

[315] Emphasis added.

[316] **CE-1**, Guidelines, s. 4.1.

- Fiscal Research;
- Business Models;
- Environmental Research;
- Socio-Economic Research;
- Other.

195. Under the heading "Classification of E&T," there are the following categories:

- Support of E&T infrastructure;
- Technology Transfer in Trades;
- Chairs and Fellowships;
- Scholarships;
- Work terms for students.

196. Reading sections 3.3 and 3.4 of the Guidelines together, two conclusions are clear.

197. First, contrary to the Claimants' sweeping Article 1106(1)(c) claim, the Guidelines do not make it mandatory to spend exclusively on R&D. Section 3.3 says that R&D "may include" any of the categories of "education and training activity/capacity" as set out in section 3.4. Accordingly, the option exists for participants to make expenditures *only* on E&T and *none* on R&D.[317]

198. Second, while expenditures under the Guidelines are mandatory, and expenditures must occur in the province (section 3.1), many of the eligible expenditures listed in section 3.4 do not necessarily "impose or enforce" a requirement or "enforce [a] commitment or undertaking" to purchase, use or accord a preference for local goods or services. For example, endowment of a chair at a university or research institute in the province does not result in the purchase of goods or services. Rather, it bestows funds on

[317] Smyth Statement, ¶ 41.

the educational institution to be used for a specific educational purpose. Establishing fellowships or scholarships for undergraduates, graduates, post-doctorals or professionals resident in the province does not compel the purchase, use or accordance of a preference to local goods or services. Rather, it involves the contribution of funds to an educational institution or individual to support E&T. Financing a work abroad term for students or professionals does not compel the purchase of goods or services from persons in the province. Establishing an in-house R&D facility in the province does not necessarily compel either the purchase of goods or services from persons in the province. These are, in principle, all qualifying expenditures under the Guidelines, and none "impose or enforce" a requirement to make an expenditure prohibited by Article 1106(1)(c). Without such a requirement, there can be no violation of NAFTA Article 1106(1)(c).

199. Below are a few examples of R&D and E&T expenditures that the Hibernia and Terra Nova proponents have made in the past in fulfilment of their obligation to support R&D and E&T in the province that did not necessarily compel the purchase of local goods or services:

- Sponsorship of an Industrial Research Chair in Ocean Engineering at MUN;[318]
- Contribution of various ice research equipment to MUN and C-CORE; [319]
- Sponsorship of the furnishing of a classroom for the MUN Centre of Management Development;[320]
- Contribution to C-CORE's general trust fund;[321]

[318] **CE-62,** Hibernia 1986 Benefits Report, s. d (2).

[319] **CE-63,** Hibernia 1987 Benefits Report, s. d (2) and (3).

[320] **CE-66,** Hibernia 1987 Benefits Report, s. E.

[321] **CE-68,** Hibernia 1989 Benefits Report, s. D(3).

- Co-operative education students from various disciplines and educational institutions employed for three or four month work terms;[322]

- Funding for the establishment of a junior research Chair in Ocean Environmental Risk Engineering at MUN; [323]

- Contribution to fund the installation of a Kongsberg (Norway) dynamic position simulator at the Marine Institute;[324]

- Contribution to a group of industrial organizations, universities and research institutions to develop a general purpose autonomous underwater vehicle (AUV);[325]

- Funding for the MUN Chair for Women in Science in Engineering.[326]

200. Expenditures that do not compel the purchase of local goods or services have already been approved by the Board under the Guidelines. The Claimants make reference in their Memorial to the Board's approval of a $250,000 donation by Petro-Canada to Memorial University "to support specialized areas of research by named researchers and scientists to further their research training."[327]

[322] **CE-71,** Hibernia 1999 Benefits Report, p. 12; **CE-73,** Hibernia 2001 Benefits Report, p. 12-13.

[323] **CE-81,** Terra Nova 1999 R&D Benefits Report, p. 5.

[324] **CE-85,** Terra Nova 2000 E&T Benefits Report, p. 7.

[325] **CE-87,** Terra Nova 2000 R&D Benefits Report, p. 5.

[326] **CE-88,** Terra Nova 2000 E&T Benefits Report, p. 11.

[327] Claimants' Memorial, ¶ 124; **CE-124,** R&D Work Expenditure Application Form: Terra Nova Young Innovators Award (May 25, 2009).

201. Further, the Claimants are actively engaged in many activities in the United States and elsewhere that, if undertaken in the province, may qualify as eligible expenditures under the Guidelines but without involving an expenditure that violates Article 1106(1)(c). For example, both Claimants have contributed millions of dollars to education programs and public policy research in the United States.[328]

202. In sum, potential R&D and E&T expenditures under the Guidelines may or may not include the purchase, use or accordance of a preference to local goods or services. Article 1106(1) can only be violated if the Claimants are compelled, that is, given no other option, to make an expenditure in violation of Article 1106(1). That is clearly not the case here and hence the Guidelines cannot be found to be inconsistent with Article 1106(1)(c).

3. Inclusion of the Accord Acts in Annex I Does Not Suggest the Guidelines are Inconsistent With Article 1106(1)

203. The Claimants argue that by including the Federal Accord Act in Annex I of the NAFTA, Canada acknowledged that R&D expenditures are inconsistent with Article 1106(1).[329]

204. This inference is mistaken. Canada has already set out above why R&D and E&T cannot reasonably be included in the rubric of Article 1106(1)(c). Given this evidence, it should not be automatically assumed, as the Claimants urge, that reference to R&D and E&T in the description of the Annex I reservation necessarily means that Canada considered that specific aspect of the Accord Acts to be inconsistent with Article 1106(1)(c).

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[328] **RE-39**, "Exxon Mobil Corporation 2008 Worldwide Contributions and Community Investments: Public Information and Policy Research," also available at: http://www.exxonmobil.com/Corporate/files/gcr_contributions_public_policy08.pdf; **RE-40**, "Exxon Mobil Corporation 2008 Worldwide Contributions and Community Investments: Higher Education," also available at: http://www.exxonmobil.com/Corporate/files/gcr_contributions_higher_ed08.pdf; **RE-47**, Exxon Mobil website: "Higher Education;" **RE-48**, Murphy Oil "Community Commitment."

[329] Claimants' Memorial, ¶¶ 153-154.

205. The reservation should be considered in light of all the elements set out in the reservation, including the description of the reservation and the reserved articles (Articles 1106 and Article 1205[330]). Read in their proper context, it is evident that the Accord Acts were included in Annex I because of other non-conforming elements, not specifically because of the R&D and E&T requirements in Article 45(3)(c). R&D and E&T were mentioned in the Annex I description out of an abundance of caution to make certain that the entire Benefits Plan provision of the Accord Acts was unassailable, not because Canada "admitted" that R&D and E&T requirements are non-compliant with Article 1106(1).

206. Annex I, Section 3 requires the Tribunal to consider "all elements of the reservation" when interpreting the reservation, and to also interpret the reservation "in the light of the relevant provisions of the Chapters against which the reservation is taken" (in this case, Chapter 11, Article 1106(1)(c) and Chapter 12, Article 1205).[331]

207. Canada's Annex I reservation, which reserves the Accord Acts, also reserves a number of other measures related to oil and gas management: *Canada Oil and Gas Production and Conservation Act* (as amended by the *Canada Oil and Gas Operations Act*), *Canada-Nova Scotia Offshore Petroleum Resources Implementation Act*, as well as measures implementing the *Yukon Oil and Gas Accord* and the *Northwest Territories Oil and Gas Accord*.[332] All of these measures are listed under the heading "measures."

208. The description of the reservation starts by describing the benefits plans under the *Canada Oil and Gas Operations Act* as being a plan for employment of Canadians and for providing Canadian companies and individuals with an opportunity to participate in the supply of goods and services. It also describes the right of the Minister to impose

[330] **RA-31**, NAFTA Article 1205 ("Local Presence") states: "No Party may require a service provider of another Party to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border provision of a service."

[331] **CA-6**, NAFTA Annex I, p. I-2, s. 3.

[332] **CA-7**, NAFTA Annex I, Schedule of Canada, pp. I-C-25 – I-C-27.

requirements designed to ensure that disadvantaged groups or individuals have access to training and employment opportunities or can participate in the supply of goods and services.[333]

209. The description goes on to state:

> 3. The *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act* and the *Canada-Newfoundland Atlantic Accord Implementation Act* have the same requirement for a benefits plan but also require that the benefits plan ensure that:
>
> (a) prior to carrying out any work or activity in the offshore area, the corporation or other body submitting the plan establish in the applicable province an office where appropriate levels of decision-making are to take place;
>
> (b) expenditures be made for research and development to be carried out in the province, and for education and training to be provided in the province; and
>
> (c) first consideration be given to goods produced or services provided from within the province, where those goods or services are competitive in terms of fair market price, quality and delivery.
>
> 4. The Boards administering the benefits plan under these acts may also require that the plan include provisions to ensure that disadvantaged individuals or groups, or corporations owned or cooperatives operated by them, participate in the supply of goods and services used in any proposed work or activity referred to in the plan.
>
> 5. In addition, Canada may impose any requirement or enforce any commitment or undertaking for the transfer of technology, a production process or other proprietary knowledge to a person of Canada in connection with the approval of development projects under the applicable Acts.[334]

[333] *Id.*, pp. I-C-25 – I-C-26.

[334] *Id.*, p. I-C-26. The description goes on to say that similar elements will be included in the Yukon and Northwest Territories legislation. *Id.*, p. I-C-27.

210. Reading the above description of the reserved measure as a whole and in light of Articles 1106 and 1205,[335] demonstrates that the description is not limited to the non-conforming elements of the measures being reserved.

211. For example, the Accord Acts' requirement that local goods and services be given first consideration (section 45(2)(d)) may be inconsistent with Article 1106(1)(c). The requirement under section 45(3)(a) of the Accord Acts to establish a local office may not conform with NAFTA Article 1205.

212. On the other hand, the description of the R&D and E&T requirement set out in section 45(3)(c) of the Accord Acts cannot be specifically linked to a prohibited requirement in Article 1106 or Article 1205. The description also includes a reference to requirements to ensure that disadvantaged individuals or groups have access to "training or employment opportunities," but neither training nor employment requirements are prohibited by Article 1106. This suggests R&D and E&T were included in the Annex I description not because they were considered by Canada to be non-conforming, but because the goal of the description was to generally describe and cover the entirety of the Benefits Plan provisions of the Accord Acts in order to avoid any doubt that Canada had the ability to require these Benefits Plans without violating its NAFTA obligations.

213. It is not surprising that Canada adopted the "belt and suspenders" approach. When the reservation was drafted, there were no decisions to guide how Article 1106 might be interpreted by future arbitral tribunals. In light of that uncertainty and the complexity of the NAFTA's performance requirements provision, it makes sense that the reservation description was drafted to be fulsome and over-inclusive, even at the risk of including aspects of the Benefits Plans that did not necessarily violate Article 1106(1). Given the importance of the Accord Acts to Canada and to NL, it was out of an abundance of caution that the description included a reference to every aspect of the Benefits Plans, including R&D and E&T, to ensure that the Benefits Plan provisions were

[335] **CA-6**, NAFTA Annex I, p. I-2, s. 3 ("In the interpretation of a reservation, all elements of the reservation shall be considered. A reservation shall be interpreted in the light of the relevant provisions of the Chapters against which the reservation is taken.").

protected under all circumstances. Mention of R&D and E&T in the reservation description cannot be taken as an admission by Canada that such provisions are inconsistent with Article 1106(1)(c).

B. In any Event, the Guidelines Fall Within the Scope of Canada's Annex I Reservation to Article 1106

214. Even if, somehow, the Guidelines are inconsistent with Article 1106(1)(c), they do not breach the Article because they fall within the scope of Canada's reservation to this provision. Canada reserved the Accord Acts, as well as any measure subordinate to that Act, from the scope of Article 1106. The Guidelines are subordinate to the Accord Acts and, therefore, are reserved from the scope of Article 1106.

1. Reservations are Interpreted According to the Vienna Convention on the Law of Treaties

215. Like all provisions in the Agreement, reservations to the NAFTA must be interpreted according to Article 31 of the VCLT. Article 31 states that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." Neither the Article, nor any other part of the VCLT, excludes reservations or exceptions from this rule.

216. Consequently, previous NAFTA Chapter 11 tribunals have applied the rule of interpretation contained in Article 31 of the VCLT when interpreting exceptions to the obligations of that chapter. For example, both the *ADF* and *UPS* tribunals applied the VCLT to construe the "plain terms" of the exception for procurement within NAFTA Article 1108.[336] Similarly, the tribunal which heard the *Mer d'Iroise* arbitration between

[336] **CA-3**, NAFTA Article 1108(7) provides that "Article ... 1102 [does] not apply to procurement by a Party ...;" **CA-16**, *ADF Group Inc. v. United States of America*, Award (ICSID ARB(AF)/00/1) January 9, 2003, ¶ 161 ("*ADF*"); **RA-71**, *United Parcel Service of America Inc. v. Canada*, Award on the Merits (UNCITRAL) May 24, 2007, ¶¶ 131, 134 (hereinafter "*UPS*").

France and the United Kingdom, held that reservations must be construed "in accordance with the natural meaning of [their] terms."[337]

217. The VCLT, and subsequent jurisprudence, demonstrate that there are no grounds for interpreting reservations from the NAFTA restrictively, as argued by the Claimants.[338] Indeed, the investment treaty tribunal in *Aguas del Tunari SA v Bolivia* expressly rejected the view that any treaty provision should be interpreted restrictively without an express direction in the treaty to do so:

> [T]he Vienna Convention represents a move away from the canons of interpretation previously common in treaty interpretation and which erroneously persist in various international decisions today. For example, the Vienna Convention does not mention the canon that treaties are to be construed narrowly, a canon that presumes States can not have intended to restrict their range of action.[339]

218. The view that exceptions or reservations should be interpreted restrictively was also rejected by the WTO Appellate Body. In *EC–Hormones,* the Appellate Body was asked to interpret Article 3.3 of the *SPS Agreement* restrictively because it is an "exception" to the rule under Article 3.1.[340] The Appellate Body disagreed:

> Article 3.1 of the *SPS Agreement* simply excludes from its scope of

[337] **RA-7**, *Case Concerning Delimitation of the Continental Shelf between the United Kingdom of Great Britain and Northern Ireland, and the French Republic* (also known as the "*Mer d'Iroise*" case), Award of 30 June 1977, in United Nations, Reports of International Arbitral Awards (UNRIAA), vol. XVIII, p. 3, ¶¶ 51, 53, 55.

[338] Claimants' Memorial, ¶ 163.

[339] **RA-2**, *Aguas del Tunari SA v. Bolivia*, Decision on Respondent's Objections to Jurisdiction (ICSID ARB/02/3), October 21, 2005, ¶ 91.

[340] **RA-49**, *Agreement on the Application of Sanitary and Phytosanitary Measures* ("SPS Agreement"), Article 3.1 ("To harmonize sanitary and phytosanitary measures on as wide a basis as possible, Members shall base their sanitary or phytosanitary measures on international standards, guidelines or recommendations, where they exist, except as otherwise provided for in this Agreement, and in particular in paragraph 3;") Article 3.3 ("Members may introduce or maintain sanitary or phytosanitary measures which result in a higher level of sanitary or phytosanitary protection than would be achieved by measures based on the relevant international standards, guidelines or recommendations, if there is a scientific justification, or as a consequence of the level of sanitary or phytosanitary protection a Member determines to be appropriate in accordance with the relevant provisions of paragraphs 1 through 8 of Article 5.").

> application the kinds of situation covered by Article 3.3...[M]erely characterizing a treaty provision as an "exception" does not by itself justify a "stricter" or "narrower" interpretation of that provision then would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in context and in light of the treaty's object and purpose, or, in other words, by applying the normal rules of treaty interpretation.[341]

219. The only authority provided by the Claimants to support their argument that reservations should be interpreted restrictively is the NAFTA Chapter 20 decision in *US – Cross Border Trucking*. The comments of the NAFTA Chapter 20 Panel should be ignored because the two grounds on which they were based are flawed.

220. First, the Panel relied on a series of decisions which pre-dated the VCLT[342] and any principles of treaty interpretation which those decisions supported have since been supplanted by the Vienna Convention. Second, the Panel's assertion that the reservation at issue was inconsistent with the objectives of the NAFTA[343] suffers from a fundamental misunderstanding about treaty reservations. Where a reservation has been accepted by the other parties to the treaty, as in this case, it cannot be inconsistent with that treaty's object and purpose. As explained by Professor Brownlie:

> The application of the criterion of compatibility with object and purpose...is left to individual states...[E]ach state decides for itself whether reservations are incompatible and some states might adopt

[341] **RA-13**, *EC - Measures Concerning Meat and Meat Products (Hormones)* (1998), WTO Report of the Appellate Body, Doc. WT/DS 26, 48, ¶ 104.

[342] **CA-24**, In the Matter of Cross-Border Trucking Services, Final Report of the Panel, February 6, 2001, fn. 262 ("Cross-Border Trucking Services").

[343] **CA-24**, *Cross-Border Trucking Services*, ¶ 237: ("the reservations in Land Transportation included in Annex I are contrary to the principal objective of NAFTA as established in its Preamble, and are also obstacles to achieving the concrete objectives agreed upon in Article 102(1).").

a liberal policy of accepting far-reaching reservations.[344]

221. Just as the Claimants' reliance on *US – Cross Border Trucking* to argue that the NAFTA reservations should be interpreted restrictively is misplaced, so is their reliance on the interpretative note to Annex I.[345] The Claimants list the requirements in the note and conclude that "[t]hese requirements show the NAFTA Parties' intent that Article 1108(1) reservations be interpreted narrowly."[346] Merely stating a conclusion does not make it so. The Claimants do not explain how the interpretative note shows that the reservations must be interpreted narrowly because they cannot. Indeed, the note shows precisely the opposite. In section 3, the note provides rules of interpretation applicable to the Annex I reservations.[347] However, nowhere in that section is a tribunal directed to ignore the VCLT and interpret reservations narrowly.

2. The Accord Acts are Reserved from the Scope of Article 1106

222. NAFTA Article 1108(1)(a) provides:

> Articles 1102, 1103, 1106 and 1107 do not apply to:
> g) any existing non-conforming measure that is maintained by

[344] **RA-6**, Brownlie, I., *Principles of Public International Law*, 7th ed. (Oxford University Press: 2008), p. 614 (hereinafter "Brownlie"). Indeed, since reservations are part of the text of the treaty (**CA-9**, VCLT, Article 31(2): "The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes ..."), the object of the treaty is necessarily the object of the reservation. See also Article 19(c) of the VCLT, which provides that a state may not formulate a reservation which is incompatible with the object and purpose of the treaty (**CA-9**, VCLT, Article 19(c): "A State may, when signing, ratifying, accepting, approving or acceding to a treaty, formulate a reservation unless ... the reservation is incompatible with the object and purpose of the treaty").

[345] Claimants' Memorial, ¶ 166.

[346] *Id.*, ¶ 166.

[347] **CA-6**, NAFTA, Annex I, Interpretive Note, s. 3 ("In the interpretation of a reservation, all elements of the reservation shall be considered. A reservation shall be interpreted in the light of the relevant provisions of the Chapters against which the reservation is taken. To the extent that: (a) the Phase-Out element provides for the phasing out of non-conforming aspects of measures, the Phase-Out element shall prevail over all other elements; (b) the Measures element is qualified by a liberalization commitment from the Description element, the Measures element as so qualified shall prevail over all other elements; and (c) the Measures element is not so qualified, the Measures element shall prevail over all other elements, unless any discrepancy between the Measures element and the other elements considered in their totality is so substantial and material that it would be unreasonable to conclude that the Measures element should prevail, in which case the other elements shall prevail to the extent of that discrepancy.").

> i) a Party at the federal level, as set out in its Schedule to Annex I …
>
> ii) a … province … as set out by a Party in its Schedule to Annex I …

223. Consequently, Article 1108(1)(a) reserves from the scope of Article 1106 "any existing non-conforming measure" listed in Annex I. In that Annex, Canada listed the Accord Acts as an existing measure that is reserved from Article 1106.[348]

3. Measures Subordinate to the Accord Acts are also Reserved from the Scope of Article 1106

224. When reserving the Accord Acts from the scope of Article 1106, Canada also reserved any measures subordinate to those Acts. Article 1108(1)(a) provides that "Article … 1106 … [does] not apply to any existing non-conforming *measure*" set out in the schedule to Annex I.[349] The interpretative note to Annex I explains at Article 2(f)(ii) that a "measure cited in the Measures element … includes any subordinate measure." The Article defines a subordinate measure as a "measure adopted or maintained under the authority of and consistent with the measure [that is expressly reserved]."

[348] At **CA-7**, NAFTA, Schedule of Canada, Annex I-C-25, p. 9, Canada expressly reserved the Federal "Canada – Newfoundland Atlantic Accord Implementation Act, S.C. 1987, c.3" from Article 1106 (as well as Article 1205). Canada added to the Annex I reservation all provincial measures existing at the time the NAFTA entered into force, including the Provincial Accord Act, through an exchange of letters with the other NAFTA parties on March 29, 1996, **RE-11**. The letters are publically available at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/letters-lettres.aspx?lang=en. Therefore, the Claimants are wrong when they state, at ¶ 167 of their Memorial, that "Canada has not made any such reservation available to the public, and Claimants are not in a position to evaluate it."

[349] Emphasis added.

225. Consequently, by reserving the Accord Acts from the scope of Article 1106, Canada also reserved from the scope of the Article any measure adopted under the authority of, and consistent with, those Acts. This was acknowledged by the Claimants.[350]

4. Reserved Subordinate Measures Include those Adopted after the NAFTA Entered Into Force

226. As explained above, Article 1108(1)(a) provides that "Article ... 1106 ... [does] not apply to any existing non-conforming measure that is maintained by a Party at the federal level [or province], as set out in its Schedule to Annex I ..." According to the general definitions for the NAFTA within Chapter 2 of the Agreement, "existing" means "in effect on the date of entry in force of this Agreement." Consequently, only measures which were in effect on the date of entry into force of the NAFTA are expressly listed in Annex I. However, this does not mean that the *subordinate measures* which are also reserved must be in effect at that date, as asserted by the Claimants.[351]

227. The word "measure" within Article 1108(1)(a) is defined in Annex I as including "any subordinate measure *adopted or maintained* under the authority of and consistent with the measure [that is expressly reserved]." Consequently, the NAFTA parties not only reserved subordinate measures that existed at the time the NAFTA entered into force and were *maintained* but also subordinate measures that were *adopted* after this date.

228. This distinction is supported by the context of the definition of a subordinate measure. The definition appears in the following provision in the interpretative note to Annex I:

> A measure cited in the measures element
>
> (i) means the measure as amended, continued or renewed as of the

[350] Claimants' Memorial, fn. 86 ("Each reservation taken pursuant to Article 1108(1) must identify the laws, regulations or other measure for which the reservation is taken. A measure identified as such 'means the measure as amended, continued or renewed as of the date of entry into force of [the treaty], and ... includes any subordinate measure adopted or maintained under the authority of and consistent with the measure.")

[351] Claimants' Memorial, ¶ 169.

> date of entry into force of this Agreement; and
>
> (ii) includes any subordinate measure adopted or maintained under the authority of and consistent with the measure.

229. Thus, part (i) of the definition includes only measures "amended, continued or renewed *as of the date of entry into force of this Agreement*." If the drafters had intended that the measures falling within part (ii) were similarly restricted then they would have added the same restriction. By not restricting part (ii) to subordinate measures "as of the date of entry into force of this Agreement," the drafters clearly expressed an intention that subordinate measures adopted after this date also fell within the definition of "measure."

230. The distinction between measures adopted and those maintained is reinforced by Article 1108(3) and Annex II. Article 1108(3) enables the NAFTA parties to reserve existing and future measures within particular sectors, which are listed in Annex II. Article 1108(3) provides that "Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party *adopts or maintains* with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II." The interpretative note to Annex II confirms that the word "maintain" refers to existing measures but "adopt" refers to future measures: "[t]he Schedule of a Party sets out, pursuant to Article ... 1108(3) ... the reservations taken by that Party with respect to specific sectors, sub-sectors or activities for which it may *maintain existing, or adopt new or more restrictive, measures* that do not conform with obligations imposed by ... Article 1106 (Performance Requirements) ..."

231. The use of the terms "maintain" and "adopt" in Article 1108 demonstrates that a measure which is maintained is one that exists at the time the Agreement entered into force and is maintained after that date. A measure which is adopted is one that came into existence after this date. Consequently, by including within the reservation for Article 1108(1)(a) "any subordinate measure *adopted or maintained* under the authority of and consistent with the [expressly reserved] measure," the NAFTA reserves both subordinate measures which existed at the date of entry into force of the Agreement as well as those which came into existence afterwards.

232. By reserving measures subordinate to measures reserved in Annex I of the NAFTA and adopted after the date the NAFTA entered into force, the Agreement reflects the reality of regulation. Laws often contain general obligations. These general obligations are frequently refined through subsequent instruments such as regulations, policies and guidelines. It is just as important to protect subsequent subsidiary measures which refine the general obligation as it is to protect the general obligation itself.

5. The Guidelines are Subordinate to the Accord Acts

233. The Accord Acts provide the Board with authority to issue guidelines to clarify the meaning of sections in the Acts, including section 45.[352] Since 1986, the Board has relied on this authority to issue over twenty guidelines to clarify the meaning of the Acts.[353] The Board issued the Guidelines to clarify the expenditures on R&D and E&T required by section 45(3)(c). Hence, the Guidelines were adopted under the authority of, and are consistent with, the Accord Acts.

234. This conclusion has been confirmed by Canadian courts. The operators challenged the Guidelines as not authorized under the Accord Acts. When rejecting that challenge, the courts determined that the Guidelines were adopted under the authority of, and are consistent with, the Accord Acts, as explained above.[354]

235. Canadian courts are best qualified to interpret the scope of Canadian legislation, including whether the Guidelines were adopted under the authority of, and are consistent with, the Accord Acts. Hence, in the absence of a suggestion that they are tainted by a denial of justice, the decisions of the Canadian courts that the Guidelines were adopted under the authority of, and are consistent with, the Accord Acts should be respected.

236. This conclusion is confirmed by international tribunals which have refused to challenge the interpretation of domestic law by domestic courts. For example, in *Serbian*

[352] **CA-11**, Federal Accord Act, s. 151.1(1). Counter Memorial, ¶¶ 29-30.

[353] Counter Memorial, ¶ 30.

[354] Counter Memorial, ¶¶ 131-141.

Loans, the Permanent Court of International Justice refused to challenge the interpretation of French contractual law by French courts:

> For the Court itself to undertake its own construction of municipal law, leaving on one side existing judicial decisions, with the ensuing danger of contradicting the construction which has been placed on such law by the highest national tribunal and which, in its results, seems to the Court reasonable, would not be in conformity with the task for which the Court has been established and would not be compatible with the principles governing the selection of its members.[355]

237. The same principle has been adopted by NAFTA Chapter 11 tribunals. When rejecting a claim for breach of Article 1110, the *Azinian* tribunal held that it could not review the decision of Mexican courts that a contract had been validly terminated. The tribunal held that "[t]he possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seised has plenary appellate jurisdiction. This is not true generally and it is not true for NAFTA."[356]

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[355] **RA-45**, *Case Concerning The Payment of Various Serbian Loans Issued in France*, (1929) P.C.I.J. (Series A) No. 14, at p. 46. See also **RA-5**, *Case Concerning The Payment in Gold of Brazilian Federal Loans Contracted in France*, (1929) P.C.I.J. No. 15, at p. 124 ("Once the Court has arrived at the conclusion that it is necessary to apply the municipal law of a particular country, there seems no doubt that it must seek to apply it as it would be applied in that country. It would not be applying the municipal law of a country if it were to apply it in a manner different from that in which that law would be applied in the country in which it is in force. It follows that the Court must pay the utmost regard to the decisions of the municipal courts of a country, for it is with the aid of their jurisprudence that it will be enabled to decide what are the rules which, in actual fact, are applied in the country the law of which is recognized as applicable in a given case. If the Court were obliged to disregard the decisions of municipal courts, the result would be that it might in certain circumstances apply rules other than those actually applied; this would seem to be contrary to the whole theory on which the application of municipal law is based;") **RA-6**, Brownlie, p. 39 ("Interpretation of their own laws by national courts is binding on an international tribunal.").

[356] **RA-3**, *Robert Azinian et al. v. United Mexican States*, Award (ICSID ARB(AF)/97/2) November 1, 1999, ¶ 99 (hereinafter "*Azinian*"). This principle was echoed by the subsequent *Mondev* tribunal. When rejecting a claim that the failure of a U.S. court to remand a particular question of fact to the jury contributed to a breach of Article 1105, the tribunal stated that "[o]n the approach adopted by Mondev, NAFTA tribunals would turn into courts of appeal, which is not their role." **CA-36**, *Mondev International Ltd. v. United States of America*, Award (ICSID ARB(AF)/99/2) October 11, 2002, ¶ 136 (hereinafter "*Mondev*"). See also **CA-33**, *International Thunderbird Gaming Corporation v. United Mexican States*, (UNCITRAL) Award of January 26, 2006, ¶ 125 (hereinafter "*Thunderbird*") ("It is not the Tribunal's function to act as a court of appeal or review in relation to the Mexican judicial system ...").

238. Thus, NAFTA Chapter 11 tribunals, just like other international tribunals, have refused to review the decisions of domestic courts. Similarly, the decisions of Canadian courts that the Guidelines were adopted under the authority of, and are consistent with, the Accord Acts should be respected. The Tribunal should follow the conclusions of Canadian courts and find that the Guidelines are subordinate to those Acts. Hence, in the event that the Guidelines are inconsistent with Article 1106(1)(c), they fall within the reservation for the Accord Acts and cannot breach Article 1106.

6. The Guidelines Do Not Amend the Accord Acts But, if They Do, They are Still Reserved From Article 1106

239. Since the Guidelines are subordinate to the Accord Acts, Canada agrees with the Claimants that the Guidelines do not amend those Acts.[357] Consequently, Article 1108(1)(c) does not apply. That Article provides that amendments to expressly reserved measures are also reserved if "the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment," with Article 1106.

240. However, even if the Guidelines are somehow an amendment to the Accord Acts, they are reserved under Article 1108(1)(c) because they do not decrease the conformity of the Acts with Article 1106. The Accord Acts require that expenditures for R&D and E&T be made in NL while the Guidelines merely ensure that the Claimants meet this requirement, as confirmed by Canadian courts. Thus, the Guidelines are only inconsistent with Article 1106 to the extent that the Accord Acts may be and, consequently, cannot decrease the conformity of the Acts with Article 1106. As a result, if the Guidelines are an amendment to the Accord Acts, they fall within the reservation for Article 1108(1)(c).

[357] Claimants' Memorial, ¶¶ 170-178.

IV. THE GUIDELINES DO NOT BREACH ARTICLE 1105

A. Summary

241. The Claimants allege that the Guidelines breach Article 1105(1) of the NAFTA. Specifically, the Claimants argue that the Guidelines frustrated their legitimate expectations and that Canada failed to provide a stable regulatory framework for the conduct of offshore oil and gas development projects in NL.[358]

242. The claim should be dismissed because:

(a) Article 1105 prescribes that the NAFTA Parties must accord the customary international law minimum standard of treatment of aliens and the Claimants have failed to prove that this standard includes protection of a foreign investor's legitimate expectations or the obligation to maintain a stable legal and business environment for investments. These are not obligations that form part of customary international law and accordingly are not part of Canada's obligations under Article 1105; and

(b) even if the Claimants had proven that the protection of legitimate expectations and a stable regulatory environment were part of customary international law, which they have not, the Guidelines do not frustrate the Claimants' legitimate expectations. Nor has Canada failed to provide a stable regulatory framework for the Claimants' investment.

B. Article 1105(1) Accords the Minimum Standard of Treatment of Aliens as Exists in Customary International Law

243. NAFTA Article 1105(1) ("Minimum Standard of Treatment") states: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."

[358] Claimants' Memorial, ¶ 194.

244. The proper interpretation of Article 1105 was confirmed by the NAFTA Free Trade Commission ("FTC") in its binding Note of Interpretation of July 31, 2001, which states:

> 1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
>
> 2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
>
> 3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).[359]

245. The FTC Note of Interpretation represents the definitive meaning to be given to Article 1105(1) and is binding on tribunals constituted under NAFTA Chapter Eleven.[360] The Claimants acknowledge that the Note of Interpretation is binding on this Tribunal.[361]

246. When determining the obligations under Article 1105, past NAFTA tribunals have confirmed that the standard is a minimum threshold below which treatment of an

[359] **CA-8**, NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter Eleven Provisions, s. 2 (July 31, 2001) (hereinafter "FTC Note of Interpretation").

[360] **CA-3**, NAFTA, Chapter 11, Article 1131(2). Since the release of the Note of Interpretation, NAFTA tribunals have acknowledged its binding effect. See **RA-28**, *Methanex Corporation v. United States of America*, (UNCITRAL) Final Award of the Tribunal on Jurisdiction and Merits, August 3, 2005, IV, Chap. C, p. 9, ¶ 20; **CA-36**, *Mondev*, ¶¶ 100-125; **CA-16**, *ADF*, ¶¶ 175-178; **RA-26**, *The Loewen Group Inc. and Raymond Loewen v. United States of America*, Award on Merits (ICSID ARB(AF)/98/3) June 26, 2003, ¶ 126 (hereinafter "*Loewen*"); **CA-51**, *Waste Management, Inc. v. United Mexican States*, Award (ICSID ARB(AF)/00/3) April 30, 2004, ¶¶ 90-91 (hereinafter "*Waste Management II*"); **CA-33**, *Thunderbird*, ¶¶ 192-193; **CA-32**, *Glamis Gold, Ltd. v. United States of America*, (UNCITRAL), Award of May 16, 2009, ¶ 599 (hereinafter "*Glamis*").

[361] Claimants' Memorial, ¶ 196.

investor by a State may not fall.[362] The tribunal in *S.D. Myers* elaborated on the international minimum standard as follows:

> The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated *in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective*. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.[363]

247. The *Glamis* tribunal summarized the minimum standard of treatment as it currently exists under customary international law:

> [A] violation of the customary international law minimum standard of treatment, as codified in Article 1105 of the NAFTA, requires an act that is *sufficiently egregious and shocking* – a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons – so as to fall below accepted international standards and constitute a breach of Article 1105.[364]

248. In short, NAFTA tribunals since the FTC Note of Interpretation have confirmed that the threshold for a violation of Article 1105 is high and requires an action that

[362] The *S.D. Myers* Tribunal explained the *raison d'être* of 1105 as follows: "The inclusion of a "minimum standard" provision is necessary to avoid what might otherwise be a gap. A government might treat an investor in a harsh, injurious and unjust manner, but do so in a way that is no different than the treatment inflicted on its own nationals. The "minimum standard" is a floor below which treatment of foreign investors must not fall, even if a government were not acting in a discriminatory manner." **CA-44**, *S.D. Myers*, ¶ 259.

[363] **CA-44**, *S.D. Myers*, ¶ 263, emphasis added.

[364] **CA-32**, *Glamis*, ¶ 627, emphasis added. Canada does not disagree with the Claimants' submission that the content of the international minimum standard may evolve over time with the development of customary international law. See Claimants' Memorial, ¶ 195. As Canada stated in its Article 1128 submission in the *ADF* case: "Canada's position has never been that the customary international law regarding the treatment of aliens was "frozen in amber" at the time of the *Neer* decision. Obviously, what is shocking or egregious in the year 2002 may differ from that which was considered shocking or egregious in 1926. Canada's position has always been that customary international law can evolve over time, but that the threshold for finding violation of minimum standard of treatment is still high." **RA-1**, *ADF Group Inc. v. United States*, Second Submission of Canada Pursuant to NAFTA Article 1128 (ICSID ARB(AF)/00/1) July 19, 2002, ¶ 33. See also **CA-32**, *Glamis*, ¶¶ 612-613, discussing *L. F. H. Neer and Pauline Neer (United States) v. Mexico* (1926) 4 R.I.A.A. 60 at 61-2.

amounts to gross misconduct or manifest unfairness such that it breaches the international minimum standard of treatment of aliens.[365]

C. The Claimants Do Not Allege Egregious, Shocking or Grossly Unfair Conduct that Could Amount to a Breach of the Customary Minimum Standard of Treatment

249. The Claimants do not allege that they were the victim of a gross denial of justice or a complete lack of due process. Nor do the Claimants argue that the Guidelines were manifestly arbitrary or that their implementation represented gross misconduct by Canada. Such claims are not made because they cannot be proven: when promulgating the Guidelines, the Board was transparent and engaged in extensive consultations with the Claimants and offered them the opportunity to provide alternatives with respect to establishing an appropriate R&D and E&T benchmark (which the Claimants declined to do).[366] The Claimants also had extensive opportunity to challenge Canada's actions in domestic courts, which found that the Board had the authority under the Accord Acts to adopt the Guidelines.[367] The Board did not enforce the Guidelines pending the outcome of the Canadian court decisions.[368]

250. The Claimants do not complain that the mechanism under the Guidelines which provides that unused R&D and E&T expenditures may be placed into a Board

[365] See for example **CA-51,** *Waste Management*, ¶ 98 ("Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant. ")

[366] Smyth Statement, ¶¶ 13-27; Claimants' Memorial ¶ 105.

[367] The Claimants' only comment with respect to the decisions of the Canadian courts is that "the Board's action ultimately was upheld as a matter of Canadian law. The case did not address the international law claims at issue in this arbitration." Claimants' Memorial, ¶ 121.

[368] Claimants' Memorial ¶ 121.

administered fund reaches the point of violating Article 1105.[369] The Claimants do not even argue that the benchmark itself, which they criticize extensively in their Memorial,[370] is manifestly arbitrary or grossly unfair to the point of violating Article 1105.[371]

251. It is clear that the Claimants do not believe that Canada acted in a way that meets the required threshold for a violation of Article 1105. The Claimants relegate their sole submission on this point to a conclusory footnote which says "if egregiousness were required, the Board's explicit repudiation of a series of direct agreements that have guided project operations for twenty years or more certainly meets that standard."[372] The Claimants make no further submissions on this point, relying solely on the concept of legitimate expectations and the vague notion of providing a stable regulatory environment as the basis of their Article 1105 claim.

[369] Claimants' only submission on this point is that the fund will require Claimants to "giv[e] money away." Claimants Memorial, ¶ 181.

[370] Claimants' Memorial, ¶¶ 108, 114.

[371] Canadian courts did not find it unreasonable for the Board to have adopted the Benchmark. See **CA-52**, Trial Court Decision, ¶ 83 ("...the Board's decision to tie research and development expenditures to industry norms in fulfillment of its obligation to determine what would be a reasonable and sufficient level of expenditure on research and development is a reasonable approach."); **CA-53**, Court of Appeal Decision, ¶ 91. In fact, it is not clear what the relevance of the Claimants' criticism of the Benchmark is for the outcome of this case. The Benchmark has no substantive impact on the Claimants' Article 1106 claim because, according to the Claimants, any prescribed level of R&D expenditure would constitute a prohibited performance requirement that is not saved by Canada's Annex I reservation. Similarly, while the Claimants argue there are problems with the Benchmark, they do not allege that these supposed defects constitute a violation of Article 1105. Finally, with respect to damages, if the Claimants are complaining that the Benchmark sets the level of R&D expenditure too high, this can only serve to inflate their own damages calculation.

[372] Claimants' Memorial, ¶ 199, fn. 367.

D. To Sustain their Article 1105 Claim, the Claimants Must First Prove the Minimum Standard of Treatment under Customary International Law Includes Protection of Legitimate Expectations and a Stable Regulatory Environment

1. The Claimants Have the Burden of Proving the Existence of a Rule of Customary International Law

252. The Claimants acknowledge that customary international law is the applicable source of law to determine the minimum standard of treatment of aliens owed in Article 1105.[373] In order to prove the existence of a rule of customary international law, two requirements must be met: consistent state practice and an understanding that such practice is required by law (*opinio juris sive necessitatis*).[374]

253. The burden of proving the existence of a rule of customary international law rests on the party that alleges it. The International Court of Justice wrote that "the Party which relies on a custom of this kind must prove that this custom is established in such a

[373] Claimants' Memorial, ¶¶ 195 – 196.

[374] **RA-15**, *Statute of the International Court of Justice*, Article. 38(1)(b) (hereinafter "*ICJ Statute*") (providing that in making decisions in accordance with international law, the Court shall apply, *inter alia*, "international custom, as evidence of a general practice accepted as law."); **RA-35**, *North Sea Continental Shelf Cases (Federal Republic of Germany v. Denmark; Federal Republic of Germany v. The Netherlands)*, Judgment [1969] I.C.J., p. 43 (it is an "indispensable requirement" to show that "State practice, including that of States whose interests are specially affected, should have been both extensive and virtually uniform in the sense of the provision invoked; -- and should moreover have occurred in such a way as to show a general recognition that a rule of law or legal obligation is involved"); **RA-8**, *Case Concerning the Continental Shelf (Libyan Arab Jamahiriyah v. Malta)* [1985] I.C.J. Rep. at p. 29, ¶ 27 ("it is of course axiomatic that the material of customary international law is to be looked for primarily in the actual practice and *opinio juris* of states..."); **RA-34**, *Case of Nicaragua v. United States (Merits)*, I.C.J. Rep. 14 (1986) pp. 108-109, ¶ 207 ("For a new customary rule to be formed, not only must the acts concerned 'amount to settled practice,' but they must be accompanied by the *opinio juris sive necessitates*. Either the States taking such action or the other States in a position to react to it, must have behaved so that their conduct "is evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it."); **RA-70**, *United Parcel Service of America Inc. v. Canada*, Award on Jurisdiction (UNCITRAL) November 22, 2002, ¶ 84 (hereinafter "*UPS - Jurisdiction Award*"); **CA-32**, *Glamis*, ¶¶ 602-603.

manner that it has become binding on the other party."[375] Scholars agree on this principle.[376] Previous NAFTA tribunals have confirmed the same.[377]

2. The Claimants Fail to Submit Evidence of State Practice and *Opinio Juris*

254. The Claimants submit no evidence of state practice or *opinio juris* to support their assertion that the minimum standard of treatment afforded to foreign investors by customary international law includes a protection of legitimate expectations or the obligation to provide a stable regulatory environment for foreign investments.[378]

255. The Claimants have merely cited various investment treaty arbitral awards, some NAFTA, others under unrelated BITs, in support of the above proposition. This falls far short of what is required to fulfil the Claimants' burden of proving a rule of custom. Arbitral awards cannot *create* customary international law – only states can create

[375] **RA-42**, *Case Concerning Rights of Nationals of the United States of America in Morocco (France v. United States)*, [1952] I.C.J. Rep. 176, p. 200 (quoting Asylum (Colom. v. Peru), 1950 I.C.J. 266).

[376] **RA-33**, Nguyen, Dallier & Pellet, *Droit International Public*, 6th ed., (LG.D.J. 1999) p. 330 (burden on party "who relies on a custom to establish its existence and exact content.") ("c'est à [la partie] qui s'appuie sur une coutume d'en établir l'existence et la portée exacte."); **RA-6**, Brownlie, p. 12 ("In practice, the proponent of a custom has the burden or proof the nature of which will vary according to the subject-matter and the form of the pleadings.")

[377] **CA-16**, *ADF*, ¶¶ 183-184 ("We are not convinced that the Investor has shown the existence, in current customary international law, of a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited, contexts) to accord fair and equitable treatment and full protection and security to foreign investments [...] any general requirement to accord "fair and equitable treatment" and "full protection and security" must be disciplined by being based upon State practice and juridical or arbitral caselaw or other sources of customary or general international law."); **RA-70**, *UPS - Jurisdiction Award*, ¶ 84 ("[T]he obligations imposed by customary international law may and do evolve. The law of state responsibility in the 1920s may well have been superseded by subsequent developments. It would be remarkable if that were not so. But relevant practice and the related understandings must still be assembled in support of a claimed rule of customary international law."); **CA-32**, *Glamis*, ¶¶ 601-603 ("If, as Claimant argues, the customary international law minimum standard of treatment has indeed moved to require something less than the "egregious," "outrageous," or "shocking" standard as elucidated by *Neer*, then the burden of establishing what the standard now requires is upon Claimant [...] it is necessarily the Claimant's place to establish a change in custom").

[378] Claimants' Memorial, ¶¶ 195, 203. It is not clear if the Claimants consider the obligation to provide a stable regulatory environment to be a stand-alone obligation under the customary international law minimum standard of treatment or a sub-set of the legitimate expecations obligation.

custom.[379] As Lauterpacht writes, "[d]ecisions of international courts are not a source of international law…[t]hey are not direct evidence of the practice of States or of what States conceive to be the law."[380] The *Glamis* tribunal endorsed the position of the United States on this point: "Arbitral awards, Respondent rightly notes, do not constitute State practice and thus cannot create or prove customary international law."[381] While arbitral awards may contain valuable analysis of State practice and *opinio juris* in relation to a particular rule of custom, they cannot by themselves substitute for actual evidence of state practice and *opinio juris*.[382]

256. This Tribunal should not accept the Claimants' casual approach to proving custom. Rather, it should insist that the Claimants adduce evidence of state practice and *opinio juris* to support their contention that the protection of legitimate expectations of foreign investors and the provision of a stable regulatory framework are part of the

[379] **RA-15**, As noted in Article 38(1)(d) of the *ICJ Statute*, judicial decisions are a "subsidiary means for the determination of rules of law."

[380] **RA-24**, Sir Hersch Lauterpacht, *The Development of International Law by the International Court*, (London: Stevens, 1958), at pp. 20-21. See also **RA-46**, Mohamed Shahabuddeen, *Precedent in the World Court* (Cambridge University Press, 1996) pp. 71-72 ("The development of customary international law depends on state practice. It is difficult to regard a decision of the Court as being in itself an expression of State practice….A decision made by it is an expression not of the practice of the litigating States, but of the judicial view taken of the relations between them on the basis of legal principles which must necessarily exclude any customary law which has not yet crystallised. The decision may recognise the existence of a new customary law and in that limited sense it may no doubt be regarded as the final stage of development, but, by itself, it cannot create one. It lacks the element of repetitiveness so prominent a feature of the evolution of customary international law.")

[381] **CA-32**, *Glamis*, ¶ 605.

[382] See **RA-11**, *Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of The Congo)*, Judgment on Preliminary Objections, I.C.J. (May 24, 2007), ¶¶ 88-91. In that case, the International Court of Justice held that reliance on investor-state arbitration awards and foreign investment protection agreements could not substitute for evidence of state practice and *opinio juris* to show a change in the customary international law rules governing diplomatic protection. The ICJ found that the Claimant had failed to prove the alleged rule of custom.

international minimum standard under customary international law. Failure to do so must result in the dismissal of the Claimants' Article 1105 claim.[383]

3. Non-NAFTA Arbitral Awards Are Only Relevant to Article 1105 if they Apply the Customary International Law Minimum Standard of Treatment

257. The Claimants rely heavily on non-NAFTA arbitral decisions interpreting stand-alone Fair and Equitable Treatment ("FET") clauses to support their contention that Article 1105(1) contains a protection of the legitimate expectations of investors and requires a stable regulatory environment.[384]

258. Such awards are not relevant in the context of NAFTA Article 1105 because they apply a different FET standard. Virtually all the non-NAFTA cases cited by the Claimants examine an autonomous FET standard that is not specifically linked to the minimum standard of treatment under customary international law.[385] Further, those awards do not assist this Tribunal in determining the minimum standard of treatment under custom because none undertake the requisite examination of state practice and *opinio juris* to prove the existence of a rule that guarantees the protection of the legitimate expectations of foreign investors and a stable regulatory environment.

259. In *TECMED*, the tribunal stated that the FET standard in the applicable BIT was "autonomous" and did not undertake any examination of the content of the minimum

[383] The Article 1105 claims in *UPS*, *ADF* and *Glamis* failed in part on the ground that the Investor had not fulfilled its burden to establish state practice and *opinio juris*. **RA-70**, *UPS - Jurisdiction Award*, ¶ 86 ("...UPS has not attempted to establish that that state practice reflects an understanding of the existence of a generally owed international legal obligation"); **CA-32**, *Glamis*, at ¶ 627 ("The Tribunal holds that Claimant has not met its burden of proving that something other than the fundamentals of the *Neer* standard apply today"); **CA-16**, *ADF*, ¶ 183.

[384] Claimants' Memorial ¶¶ 194-203.

[385] **RA-12**, Dolzer and Schreuer, *Principles of International Investment Law* (Oxford: Oxford University Press, 2008), p. 126 (hereinafter "Dolzer and Schreuer") ("In contrast to the NAFTA practice, arbitral awards applying treaties that do not contain statements about the relationship of FET to customary international law have interpreted the relevant provisions in BITs autonomously on the basis of their respective wording.").

standard of treatment under customary international law.[386] It was for this reason that the NAFTA tribunal in *Glamis* found that "the language or analysis of the *TECMED* award is not relevant to the Tribunal's consideration" of an Article 1105 breach.[387]

260. In *Saluka*, the tribunal also applied an autonomous FET standard that it interpreted pursuant to the VCLT, rather than a standard based on customary international law.[388] The tribunal distinguished the standard it had to apply from NAFTA Article 1105:

> [T]his Tribunal has to limit itself to the interpretation of the "fair and equitable treatment" standard as embodied in Article 3.1 of the Treaty. That Article omits any express reference to the customary minimum standard. The interpretation of Article 3.1 does not therefore share the difficulty that may arise under treaties (*such as the NAFTA*) which expressly tie the 'fair and equitable' treatment standard to the customary minimum standard. Avoidance of these difficulties may even be regarded as the very purpose of the lack of a reference to an international standard in the Treaty. This clearly points to the autonomous character of a "fair and equitable treatment" standard such as the one laid down in Article 3.1 of the Treaty.[389]

261. There was similarly no reference to the minimum standard of treatment under customary international law in the applicable BIT in the *Eureko, Biwater Gauff, Azurix,*

[386] **CA-49**, *Technicas Medioambientales Tecmed, S.V. v. United Mexican States*, Award (ICSID ARB(AF)/00/2) May 29, 2003, ¶¶ 155-156 (hereinafter "*TECMED*").

[387] **CA-32**, *Glamis*, ¶ 610.

[388] **CA-43**, *Saluka Investments B.V. v. Czech Republic*, Partial Award (UNCITRAL) March 17, 2006, ¶¶ 294, 296, 305 (hereinafter "*Saluka*").

[389] **CA-43**, *Saluka*, ¶ 294, emphasis added.

Sempra or *Siemens* cases cited by the Claimants, and those tribunals did not undertake any analysis of state practice or *opinio juris*.[390]

262. Other non-NAFTA tribunals have made similar observations. The *MTD* case, relied on by the Claimants in support of its proposition that FET obliges a State to provide a stable legal and business environment for investors,[391] noted that the applicable FET provision it examined was autonomous, not a standard of customary international law, and was therefore to be interpreted pursuant to the VCLT "ordinary meaning" standard.[392] Similarly, the tribunal in *National Grid* observed that since "there is no reference to the minimum standard of treatment under international law in the Treaty in contrast to the language of NAFTA, the Tribunal will proceed to examine the ordinary meaning of 'fair' and 'equitable'"[393]

263. In summary, the position taken by the tribunal in *Glamis* is apposite:

> The Tribunal therefore holds that it may look solely to arbitral awards – including BIT awards – that seek to be understood by reference to the customary international law minimum standard of treatment, as opposed to any autonomous standard.[394]

264. The Claimants suggest that their reliance on non-NAFTA arbitral awards is appropriate because there is no difference between the international minimum standard in

[390] **CA-27**, *Eureko B.V. v. Republic of Poland*, Partial Award of August 19, 2005, ¶¶ 77, 231-235; **CA-20**, *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, Award (ICSID ARB/05/22) July 24, 2008, ¶ 586 (hereinafter "*Biwater Gauff*"); **CA-19**, *Azurix v. Argentine Republic*, Award (ICSID ARB/01/12), July 14, 2006, ¶¶ 361, 363 (hereinafter "*Azurix*"); **CA-45**, *Sempra Energy International v. Argentine Republic*, Award (ICSID ARB/02/16) September 28, 2007, ¶ 302; **CA-46**, *Siemens A.G. v. Argentine Republic*, Award (ICSID ARB(AF)/02/8) February 6, 2007, ¶ 291 (hereinafter "*Siemens*").

[391] Claimants' Memorial ¶ 203.

[392] **CA-38**, *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile*, Award (ICSID ARB/01/7) May 25, 2004, ¶¶ 111-112 (hereinafter "*MTD*") ("The Tribunal further notes that there is no reference to customary international law in the BIT in relation to fair and equitable treatment...[the Tribunal] is obliged to apply the provisions of the BIT and interpret them in accordance with the [VCLT].").

[393] **RA-32**, *National Grid P.L.C., v. Argentine Republic*, Award (UNCITRAL) November 3, 2008, ¶ 167.

[394] **CA-32**, *Glamis*, ¶ 611.

NAFTA and that of autonomous FET provisions in BITs under which these awards were rendered.[395] This is conclusory and unsupported. The Claimants provide no evidence as to what the international minimum standard is under customary international law, nor do the arbitral cases they rely on contain evidence thereof. The FTC Note of Interpretation is clear on this point: the concept of "fair and equitable treatment" in Article 1105 "[does] not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."[396] The *Mondev* tribunal stated:

> The FTC interpretation makes it clear that in Article 1105(1) the terms "fair and equitable treatment" and "full protection and security" are, in the view of the NAFTA Parties, references to *existing elements of the customary international law standard and are not intended to add novel elements to that standard.*[397]

265. The Claimants' only evidence to support their contention that the standards are the same is unreliable. The *CMS v. Argentina* tribunal summarily, without evidence or analysis, stated that the international law minimum standard of treatment was the same as FET.[398] The observation in *Biwater Gauff* that the content of the treaty standard of FET is

[395] Claimants' Memorial, ¶ 200.

[396] **CA-6**, NAFTA Annex I, Interpretative Note, ¶ 2.

[397] **CA-36**, *Mondev*, ¶ 122, emphasis added. See also **RA-70**, *UPS - Jurisdiction Award*, ¶ 97 ("[W]e agree in any event that the obligation to accord fair and equitable treatment is not in addition to or beyond the minimum standard."); **RA-26**, *Loewen*, ¶ 128 ("'fair and equitable treatment' and 'full protection and security' are not free-standing obligations. They constitute obligations only to the extent that they are recognized by customary international law."); **CA-32**, *Glamis*, ¶ 609 ("Claimant has agreed with this distinction between customary international law and autonomous treaty standards but argues that, with respect to this particular standard, BIT jurisprudence has 'converged with customary international law in this area.' The Tribunal finds this to be an over-statement. Certainly, it is possible that some BITs converge with the requirements established by customary international law; there are, however, numerous BITs that have been interpreted as going beyond customary international law, and thereby requiring more than that to which the NAFTA State Parties have agreed. It is thus necessary to look at the underlying fair and equitable treatment clause of each treaty, and the reviewing tribunal's analysis of that treaty, to determine whether or not they are drafted with an intent to refer to customary international law."); **RA-12**, Dolzer & Schreuer, p. 16 ("...in the context of NAFTA, the three state parties decided that the standards of "fair and equitable treatment" and "full protection and security" must be understood to require host states to observe customary international law and not more demanding autonomous treaty-based standards.").

[398] **CA-21**, *CMS Gas Transmission Co. v. Argentine Republic* (ICSID ARB/01/8) Award, May 12, 2005, ¶ 284 (hereinafter "*CMS*").

not materially different from the content of the minimum standard of treatment in customary international law is also not authoritative.[399] First, it had no evidentiary basis for expressing this as an accurate statement of law because neither the tribunal nor the arbitral awards it relied on undertook any analysis of state practice or *opinio juris* that would evidence the content of the minimum standard of treatment under customary international law.[400] Second, the *Biwater Gauff* tribunal noted that the applicable BIT made no reference to the minimum standard of treatment under customary international law and recognized that the parties to the BIT intended to adopt an "an autonomous standard" that left it open to the tribunal to determine the precise scope based on whether the tribunal felt the conduct "is fair and equitable or unfair and inequitable."[401] This is clearly not permitted under Article 1105, which demands a rule of customary international law be proven. Accordingly, the *Biwater Gauff* dicta that the standards are the same cannot be relied upon as authoritative.

266. *Occidental* is similarly unhelpful. In that case, the tribunal noted that the question of whether the FET standard in the treaty was more demanding than the minimum standard of treatment under customary international law did not arise, so it had no need to undertake the analysis of state practice and *opinio juris* that Article 1105 requires.[402]

267. Simply put, the Claimants have failed to fulfil their burden to prove the content of the minimum standard of treatment under customary international law.

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[399] Claimants' Memorial, ¶ 200, citing **CA-20**, *Biwater Gauff*, ¶ 592.

[400] See **CA-20,** *Biwater Gauff*, ¶¶ 591, 595, where the Tribunal cites *Saluka, Azurix, CMS Gas* and *Occidental* for support. As explained in this section, none of those cited cases actually undertakes an analysis of what the minimum standard of treatment is under customary international law, making reliance thereon insufficient support for the Claimants' assertion. The same can be said with respect to *Siemens*. See **CA-46** and Claimants' Memorial ¶ 200 fn. 368.

[401] **CA-20**, *Biwater Gauff*, ¶¶ 591, 595.

[402] **CA-39**, *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award of July 1, 2004, ¶ 192 (hereinafter "*Occidental*") ("The question whether there could be a Treaty standard more demanding than a customary international law standard that has been painfully discussed in the context of NAFTA and other free trade agreements does not therefore arise in this case."). There was no reference to the minimum standard of treatment under customary international law in Article II(3)(a) of the US-Ecuador BIT, which was at issue in that case.

4. Customary International Law Does Not Include an Obligation to Protect an Investor's Legitimate Expectations or Provide a Stable Regulatory Environment

268. As noted above, the Claimants have failed to fulfil their burden to prove the minimum standard of treatment includes the protection of an investor's legitimate expectations or the obligation to provide a stable regulatory environment for foreign investments. In any event, it is difficult to see how either obligation could have crystallized into a particular rule of custom. For example, expectations that may be legitimate can arise out of a contract between a State and an investor, but it has been long recognized that a mere breach of contract by the State does not rise to the level of a violation of international law.[403] If it were true that customary international law required States to refrain from regulating in a way that frustrated the expectations of foreign investors, it would be impossible for States to regulate at all. The same can be said for the assertion that States are bound by custom to provide a "stable regulatory framework" for foreign investors. Not only do the cases relied on by the Claimants in support of this purported rule contain no evidence of state practice or *opinio juris*,[404] the implications of such a vague obligation would subject States to endless suits by foreign investors advocating that any change in laws or regulations is "unstable" and thus violates international law.[405]

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[403] **CA-51,** *Waste Management*, ¶ 73; **RA-3**, *Azinian*, ¶ 87.

[404] Claimants' Memorial, ¶ 203. There was no reference to the minimum standard of treatment in customary international law in the FET provisions examined by the cases cited by Claimants. **CA-26**, *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, Award (ICSID ARB/01/3) May 22, 2007 ¶¶ 258-259; **CA-39**, *Occidental*, ¶¶ 180, 192; **CA-21**, *CMS*, ¶ 284; **CA-34**, *LG&E Energy Corp. v. The Argentine Republic*, Decision on Liability (ICSID ARB/02/1) October 3, 2006, ¶ 122 (hereinafter "*LG&E –Liability*"); **CA-25**, *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, Award (ICSID ARB/04/19) August 18, 2008, ¶¶ 333-337 (hereinafter "*Duke Energy*"); **CA-38**, *MTD*, ¶¶ 111-112.

[405] See **CA-43**, *Saluka*, ¶ 305 ("No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged."); **RA-38**, *Parkerings-Compagniet AS v. Republic of Lithuania*, Award (ICSID ARB/05/8) September 11, 2007, ¶ 332 ("It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilization clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made his investment.").

269. Even the NAFTA cases on which the Claimants rely do not conclude that there is an obligation in customary international law to protect the legitimate expectations of investors. In *Glamis*, the tribunal considered it possible that "the creation by the State of objective expectations *in order to induce* investment and the subsequent repudiation of those expectations" could be a factor as to whether there has been a sufficiently egregious and shocking act so as to fall below the minimum standard of treatment.[406] The *Glamis* tribunal did not, contrary to the selective submission of the Claimants,[407] suggest that frustration of the legitimate expectations of an investor was an obligation in and of itself, and took "no position on the type or nature of repudiations measures that would be necessary to violate international obligations."[408] The *Waste Management II* tribunal only went as far as to say that the breach of representations made by the host State, which were reasonably relied on by the investor, was "relevant" as to whether the NAFTA party acted in a way that was "grossly unfair, unjust or idiosyncratic" or exhibited "a complete lack of transparency and candour in an administrative process."[409] Similarly, the *Thunderbird* tribunal majority saw legitimate expectations of the investor as part of the NAFTA "context" but found that the impugned actions would still have to rise to a level that amounted to a "gross denial of justice or manifest arbitratiness falling below acceptable international standards."[410]

270. In sum, while NAFTA tribunals have considered as a relevant element the repudiation of the legitimate expectations of foreign investors, assuming they reasonably existed at the time of the investment and are based on specific representations (discussed below), they have not found that the failure to fulfil legitimate expectations constituted in

[406] **CA-32**, *Glamis*, ¶ 627, emphasis added.

[407] Claimants' Memorial, ¶ 200, fn. 370 citing **CA-32**, *Glamis*, ¶ 621 ("legitimate expectations relate to an examination under Article 1105(1)").

[408] **CA-32**, *Glamis*, ¶ 627, fn. 1278.

[409] **CA-51**, *Waste Management*, ¶ 98.

[410] **CA-33**, *Thunderbird*, ¶¶ 147, 194.

and of itself a breach of a rule of customary international law part of the minimum standard of treatment under Article 1105.

E. Even If Article 1105 Requires the Protection of Legitimate Expectations, the Claimants Have Failed to Demonstrate Any Breach

1. Legitimate Expectations Must be Reasonable and Based on Specific Assurances Given at the Time of the Investment in Order to Induce the Investment

271. The Claimants give no clear guidance in their Memorial how to determine that an investor had certain expectations and whether such expectations were reasonable and legitimate under the circumstances. Previous arbitral tribunals have identified several prerequisites necessary for the expectations of a foreign investor to be entitled to protection. First, legitimate expectations must be based on objective rather than the subjective expectations of the investor.[411] Second, there must have been a specific assurance or promise by the State to induce the investment which was relied on by the investor.[412] Third, the relevant expectations must be those existing at the time the investor decided to make the investment.[413] Finally, to assess the reasonableness and legitimacy of the Claimants' expectations, the Tribunal should take into account "all

[411] **RA-14**, *EDF (Services) Limited v. Romania*, Award (ICSID ARB/05/13) October 8, 2009, ¶ 219 ("Legitimate expectations cannot be solely the subjective expectations of the investor. They must be examined as the expectations at the time the investment is made, as they may be deduced from all the circumstances of the case, due regard being paid to the host State's power to regulate its economic life in the public interest."); **CA-32**, *Glamis*, ¶ 627 ("Creation by the state of objective expectations in order to induce investment...").

[412] **CA-32**, *Glamis*, ¶ 620 ("Merely not living up to expectations cannot be sufficient to find a breach of Article 1105 of the NAFTA. Instead, Article 1105(1) requires the evaluation of whether the State made any specific assurance or commitment to the investor so as to induce its expectations."); **CA-51**, *Waste Management*, ¶ 98 (there must be a "breach of representations made by the host State which were reasonably relied on by the claimant."). **RA-14**, *EDF*, ¶ 217 ("Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate or reasonable.")

[413] **RA-4**, *Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. v. Islamic Republic of Pakistan*, Award (ICSID ARB/03/29) August 27, 2009, ¶¶ 190-191 (hereinafter "*Bayindir*") ("Several awards have stressed that the expectations to be taken into account are those existing at the time when the investor made the decision to invest. There is no reason not to follow this view here."); **CA-25**, *Duke Energy*, ¶ 340.

circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State."[414]

272. The Claimants cannot meet any of these criteria. By submitting that their expectation was that there would be no minimum amount required to be spent on R&D and E&T,[415] the Claimants are in essence arguing that *any* expenditure benchmark required by the Board, large or small, fixed or percentage based, constitutes a violation of Article 1105. As demonstrated further below, this could not have objectively or reasonably been the Claimants' expectation at any point.

2. The Claimants' Expectations Regarding Hibernia

a) Expectations Arising Out of the Accord and the Accord Acts

273. The Accord clearly sets out the expectations of the federal and NL governments with respect to R&D and E&T: "Benefits plans...shall provide for expenditures to be made on research and development, and education and training, to be conducted within the province. *Expenditures made by companies active in the offshore pursuant to this requirement shall be approved by the Board.*"[416] The Claimants have always been fully aware of this requirement,[417] which has remained unchanged since the Accord was signed in 1985 and is integral to the interpretation and implementation of the Accord Acts,

[414] **CA-25**, *Duke Energy*, ¶ 340, cited with approval in **RA-4**, *Bayindir*, ¶ 192. See also **CA-43**, *Saluka*, ¶ 304 ("This Tribunal would observe, however, that while it subscribes to the general thrust of these and similar statements, it may be that, if their terms were to be taken too literally, they would impose upon host States' obligations which would be inappropriate and unrealistic. Moreover, the scope of the Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness *in light of the circumstances.*")

[415] Claimants' Memorial, ¶ 72.

[416] **CA-10**, Accord, s. 55, emphasis added.

[417] Claimants relegate this point to a footnote. Claimants' Memorial, ¶ 43, fn. 61.

including the responsibilities of the Board.[418] The Canadian courts have already found that section 55 of the Accord was a basis for the Board's authority to issue the Guidelines.[419]

274. Section 45(3) of the Accord Acts sets out that the benefits plan "shall contain provisions *intended to ensure that*...(c) expenditures *shall be made* for research and development to be carried out in the Province and for education and training to be provided in the Province."[420] The intent is clear: there is an affirmative and continuing obligation on the part of the Claimants to make R&D and E&T expenditures. There is no option for the Claimants to choose not to spend money on R&D and E&T – they are required to do so, and the Accord Acts do not give the Claimants the discretion to decide that it may stop doing so.[421] Canada never made any representations to the contrary and the Claimants cannot argue otherwise.

275. In addition to its express mandate to approve R&D and E&T expenditures set out in Article 55 of the Accord, the Accord Acts give the Board the discretion to issue guidelines as to the application and administration of section 45.[422] Accordingly, the

[418] **CA-11,** Federal Accord Act, s. 17(1) ("The Board shall perform such duties and functions as are conferred or imposed on the Board by or pursuant to the Atlantic Accord or this Act."). In its decision, the Court of Appeal referred to the Supreme Court of Canada's interpretation of the Accord Acts in a different case involving Claimant Mobil in which it was noted that "The federal and provincial [Accord] Implementation Acts gave effect to the provisions of the Atlantic Accord, and *the Board must conduct itself with the [Atlantic] Accord in mind: s.17(1),*" emphasis added. **CA-53**, Court of Appeal Decision, ¶ 30 per Justice Welsh, citing **RA-29,** *Mobil Oil Canada v. Canada-Newfoundland Offshore Petroleum Board,* [1994] 1 S.C.R. 202, p. 20.

[419] **CA-53**, Court of Appeal Decision, ¶ 120, per Justice Barry ("In the present case, clause 55 of the [Atlantic] Accord expressly and clearly provides that expenditures made by companies on research and development shall be approved by the Board.")

[420] Emphasis added.

[421] **CA-52**, Trial Court Decision, ¶ 46 ("To adopt the applicants' submissions would be to allow them to unilaterally determine what amount to spend on research and development and education and training. They could choose to spend nothing and simply report that they were spending nothing. This, in their interpretation, would be the fulfillment of their obligation. As I have already stated, this is not a reasonable and purposive interpretation of the legislation and the Board's authority and obligations under the Accord and the *Acts*.")

[422] **CA-11**, Federal Accord Act, s. 151.1(1).

Board has the ongoing obligation to fulfill the intention of section 45 of the Accord Acts, which requires that the Benefits Plan "ensure that...expenditures shall be made" on R&D and E&T in the province. Canada never made any representations to the Claimants to suggest otherwise.

276. The Canadian courts confirmed that the Board had the legal authority to impose the Guidelines.[423] The Claimants do not challenge the reasoning of the Canadian courts,[424] nor should this Tribunal.

277. The Claimants were aware of the sustainable development goals of NL at the time of their entry into the Hibernia and Terra Nova projects, and they were aware at all times of the legislative purpose of the Accord Acts and Accord to ensure a legacy in the province from the limited resources of offshore oil and gas.[425] The Claimants were aware of the relevant provisions in the Accord and Accord Acts, which have not changed since the time of their enactment. The Claimants were aware of the Board's authority to approve R&D and E&T expenditures and to issue guidelines setting out the parameters of what it considers appropriate with respect to offshore oil and gas operations. As noted above, the Board has issued guidelines many times in the past and continues to do so.[426] Objectively, the Claimants' so-called "legitimate" expectation that it had the right to self-judge the adequacy and scope of its R&D and E&T expenditure obligations is neither legitimate nor reasonable. The Canadian courts rejected this argument, and so should this Tribunal.

[423] **CA-53**, Court of Appeal Decision, ¶ 74 ("the 1986 approval of the Hibernia benefits plan provided for the Board's continuous monitoring of the company's expenditures on research and development...the Board reasonably concluded that it has the authority to determine on a continuing basis whether the company is making adequate expenditures."). Justice Barry also wrote: "...the Board, by requiring reporting of research and development expenditures, in its Decisions 86.01 and 97.02, also implicitly reserved for itself on-going authority to put in place further research and development requirements, should monitoring indicate this was warranted. Otherwise, what was the purpose of the monitoring?" **CA-53**, Court of Appeal Decision, ¶ 126.

[424] Claimants' Memorial, ¶ 121.

[425] Counter Memorial, ¶¶ 20-28.

[426] Counter Memorial, ¶¶ 29-30.

b) Expectations Arising Out of the Hibernia Benefits Plan

278. As described above, there were no promises or assurances given by the Board to the Claimants that it would not set a minimum expenditure requirement for R&D and E&T.[427] To the contrary, the Claimants had reason to expect the opposite. The 1986 Exploration Phase Guidelines stated explicitly that guidelines on R&D and E&T expenditure amounts would be issued.[428] The 1986 Exploration Phase Guidelines were released *before* Mobil submitted its Supplementary Benefits Plan and, as the Claimants acknowledge,[429] *before* the Board's approval of the Benefits Plan. It is difficult to reconcile the Claimants' argument that once the Benefits Plan was approved, they did not consider it possible that the Board could step in and set R&D and E&T expenditure levels when the 1986 Exploration Phase Guidelines said that the Board would do exactly that.

279. There was no assurance in the decision approving the Hibernia Benefits Plan, explicit or implicit, that the Board would not in the future set an R&D and E&T expenditure benchmark if the Board felt that the Claimants were not fulfilling their obligations under the Benefits Plan and Accord Acts. The Board described the development of the Hibernia Benefits Plan as an "evolutionary process" that would evolve over time, depending on how the Claimants undertook to fulfil their R&D and E&T commitments.[430]

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[427] Indeed, as Justice Welsh noted, the Claimants did not ask for, nor did it receive any such assurances. **CA-53**, Court of Appeal Decision, ¶ 65 ("When Hibernia Management and Petro-Canada entered into their agreements and their benefits plans were approved, they were aware of these provisions, and could, at the initial stage, have sought more specific language regarding expenditures on research and development."). It should also be noted that the oil and gas industry, including Mobil Canada, was consulted by government with respect to the drafting of the Accord and the Accord Acts, but Mobil did not seek more specific language regarding their R&D and E&T spending obligations.

[428] **CE-32**, 1986 Exploration Phase Guidelines, ¶¶ 3.5 and 3.6, pp. 6-7 ("The company is required to outline its proposed expenditures and activities on research and development [and education and training] to be carried out within the Province. (Guidelines for expenditure amounts, etc. will be developed by the Board).")

[429] Claimants' Memorial ¶ 46.

[430] **CE-47**, Hibernia Decision 86.0, p. 8. See also Fitzgerald Statement, ¶ 47-54.

280. The Claimants committed themselves in the Benefits Plan to report their expenditures to the Board for the purpose of "enabl[ing] the Board to monitor the level of efforts and benefits achieved and to assist in promoting maximum benefits."[431] Decision 86.01 stated that the Board would "monitor the project, as it proceeds, to ensure that the Proponent complies with the commitments" in the Benefits Plan.[432] This clearly indicates that the Board maintained the discretion to determine if and when enough was being spent. As Justice Barry noted, there would be no point of such reporting and monitoring if the Board was unable to intervene when it felt the proponents were not fulfilling their commitments.[433] Just because the Board felt at the time of the Benefits Plan approval that it was unnecessary to exercise its authority to stipulate a minimum required amount of spending for R&D and E&T,[434] does not mean there was an assurance given to the Claimants that it would not do so in the future. There was never such a promise.

281. The Claimants submit that there was no requirement in the Hibernia Benefits Plan to spend a fixed amount or percentage on R&D and E&T and no requirement for pre-approval by the Board.[435] However, the Claimants understood that they had an obligation to continue to spend on R&D and E&T,[436] and they understood that the Board had the obligation to monitor and approve such expenses to ensure they were fulfilling their Benefits Plan commitments and obligations under the Accord Acts.[437] The authority to monitor the Claimants' "level of efforts and benefits achieved"[438] and to approve the

[431] **CE-46**, Supplementary Benefits Plan, p. 4.

[432] **CE-47**, Hibernia Decision 86.0, p. 8.

[433] **CA-53**, Court of Appeal Decision, ¶ 126. See also **CA-52**, Trial Court Decision, ¶ 46.

[434] Fitzgerald Statement, ¶¶ 49-51.

[435] Claimants' Memorial, ¶ 59.

[436] **CA-11**, Federal Accord Act, s. 45(3)(c); **CE-46**, Supplementary Benefits Plan, p. 7; **CE-47**, Hibernia Decision 86.0, p. 25.

[437] **CA-10**, Accord, s. 55; **CE-47**, Hibernia Decision 86.0, p. 8.

[438] **CE-46**, Supplementary Benefits Plan, p. 4.

Claimants' expenses gives the Board the authority to determine what does and does not satisfy the statutory requirement to spend on R&D and E&T.

282. Nor was there any representation by the Board to the Claimants that R&D and E&T spending were to be based solely on technical project needs.[439] The Accord, the Accord Acts and the Benefits Plan make no such stipulation.[440] Rather, the Claimants' promise to "continue" to support and promote R&D "to solve problems unique to the Canadian offshore environment" is a promise of ongoing support for a broad category of R&D that could conceivably encompass many issues not directly related to the project. Indeed, as noted above,[441] the Claimants reported numerous expenditures in annual benefits reports that did not directly relate to project needs. This demonstrates that the Claimants had a broader understanding of its R&D and E&T spending obligations than what they are claiming now.

283. In sum, as of June 1986 when the Benefits Plan was approved by the Board, the only objective and reasonable expectations that the Claimants could have had with respect to R&D and E&T spending obligations are the following:

- R&D and E&T expenditures "made by companies active in the offshore...shall be approved by the Board;"[442]
- the Benefits Plan is intended to "ensure" that expenditures "shall" be made on R&D and E&T in the Province;[443]
- the Claimants had the obligation to "continue" to support and promote R&D,[444] and had the ongoing obligation to submit details of its R&D and

[439] Claimants' Memorial, ¶ 72.

[440] See **CA-53**, Court of Appeal Decision, ¶¶ 127-135.

[441] Counter Memorial, ¶¶ 82-84.

[442] **CA-10**, Accord, s. 55.

[443] **CA-11**, Federal Accord Act, s. 45.

E&T expenditures to enable the Board to "monitor the level of efforts and benefits achieved;"[445] and

- the Board would "monitor the project...to ensure that the Proponent complies with the [benefits] commitments."[446]

c) Post-Benefits Plan Approval

284. Subsequent guidelines and practice of the Board and the Claimants did not change the Claimants' expectations or the conditions of the Benefits Plan approval.

285. The Claimants argue that the Board "abandoned" the idea that it would issue guidelines for R&D and E&T expenditure amounts when it issued the 1987 Exploration Phase Guidelines.[447] This is fallacious. The Board made no assurances to the Claimants that it had "abandoned" the idea of issuing R&D and E&T expenditure guidelines in the future. To the contrary, as noted above,[448] the 1987 Exploration Phase Guidelines said clearly that the Board would engage in an ongoing review of the fulfilment of the operator's exploration program and reiterated the intention of the Accord Acts to ensure R&D and E&T expenditures are made.[449] The 1987 Exploration Phase Guidelines also required the company to submit, in its Annual Report, a description of the R&D and E&T activities undertaken by the company in the province and include expenditure amounts.[450]

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[444] **CE-6**, Memorandum of Understanding: Canada/Newfoundland Benefits – Hibernia Development Project (April 18, 1986); **CE-45**, Hibernia Benefits Plan; **CE-46**, Supplementary Benefits Plan; **CE-47**, Hibernia Decision 86.01, p. 25.

[445] **CE-46**, Supplementary Benefits Plan, p. 4.

[446] **CE-47**, Hibernia Decision 86.01, s. 2.1.

[447] Claimants' Memorial, ¶¶ 49, 209.

[448] Counter Memorial, ¶¶ 51-53.

[449] **CE-33**, 1987 Exploration Phase Guidelines, s. 2.2.

[450] **CE-33**, 1987 Exploration Phase Guidelines, s. 4.4.

286. Finally, the 1987 Exploration Phase Guidelines explicitly noted that "[t]hese Guidelines...*may be revised from time to time* following consultation with industry."[451] The Claimants were put on notice that the 1987 Guidelines were not set in stone and the Board retained the discretion to change them. As had always been the case, if project proponents were not fulfilling their commitments under the Accord Act and Hibernia Benefits Plan, the Board had the authority to issue guidelines to ensure the proper application of section 45. As confirmed by John Fitzgerald, the Board decided to reserve judgment on whether the Claimants were fulfilling their obligations under the law and the decision approving the Benefits Plan; if they were not, the Board would step in to give guidance as to its expectations.[452]

287. In 1988, the Board issued the 1988 Development Guidelines, a document which the Claimants do not mention in their Memorial.[453] That document provided further guidance with respect to the preparation of a Benefits Plan under section 45 of the Accord Acts.[454] The 1988 Development Guidelines note that even after a Benefits Plan is approved by the Board, the proponents "will be required to satisfy the Board's requirements in a number of areas, both prior to and subsequent to the commencement of production operations."[455] The 1988 Development Guidelines reiterated the requirement (which reflected the Hibernia Supplementary Benefits Plan) that the proponents undertake "off-shore related" (not "project-specific") R&D, as is required by the Accord Acts, and to report its expenditures thereon.[456] The 1988 Development Guidelines reiterated the Board's intention to monitor the proponent's efforts with respect to R&D and E&T, and indicated that "details of the Board's monitoring and reporting

[451] **CE-33**, 1987 Exploration Phase Guidelines, s. 1.0, emphasis added.

[452] Fitzgerald Statement ¶ 54.

[453] The Claimants are incorrect to state that there were no other relevant guidelines issued between 1987 and 2004. Claimants' Memorial ¶ 52.

[454] Way Statement, ¶¶ 31-34.

[455] **RE-9**, 1988 Development Application Guidelines, s. 1.5.

[456] *Id.*

requirements will be established in consultation with the proponent after submission of the Benefits Plan."[457]

288. The 1988 Development Guidelines is further proof that the Board, not the Claimants, had the discretion to determine whether the R&D and E&T expenditure commitments were being fulfilled. The Board always had the authority to step in should the proponents not make sufficient expenditures to fulfil statutory requirements.[458] If the Claimants had mistaken expectations to the contrary, they were not based on any assurances given by the Board.

289. Nothing in the years after the Benefits Plan was approved changed the objective expectations the Claimants could reasonably have had. The Claimants' characterization of various post-Benefits Plan agreements as being "further assurances" and "express promises" with respect to R&D is disengenuous.[459] The financial agreements with the governments had no bearing on R&D and E&T obligations,[460] nor did the various development plan updates,[461] so there was no need to further address R&D and E&T in those documents.

3. The Claimants' Expectations Regarding the Terra Nova Project

290. The Claimants submit that their expectations regarding the Terra Nova project were the same as those regarding the Hibernia Project and that it relied on its Hibernia

[457] *Id.*, s. 5.5.2. See Counter Memorial, ¶¶ 54-57.

[458] **CA-52**, Trial Court Decision, ¶ 52 ("It was left to the Board to determine from time to time what would amount to an appropriate and adequate level of expenditure. This could not and was not determined at the beginning of the project and this was acknowledged by the applicants."); Fitzgerald Statement, ¶¶ 49-54.

[459] Claimants' Memorial, ¶¶ 208, 211.

[460] As noted above, the decision by the federal and provincial governments to step in with financial assistance had no impact on the Claimants' R&D and E&T requirements under the Accord Acts. See Counter Memorial, ¶¶ 58-61.

[461] Claimants' Memorial, ¶ 210.

experience with respect to the Terra Nova Project.[462] If this was the case, then the Claimants should have objectively and reasonably had the understanding that at the time of the Terra Nova Benefits Plan approval in 1997, the Board had the authority to approve R&D and E&T expenditures,[463] the authority to ensure that expenditures shall be made on R&D and E&T, [464] and to issue guidelines with respect thereto.[465]

291. When the Board approved the Terra Nova Benefits Plan in 1997, the Claimants were put on notice that the Board was sceptical of their proposed efforts to spend on R&D and E&T during the Terra Nova project and warned that the Benefits Plan was approved on the condition that they continued to satisfy the Board with respect to their benefits expenditures.

292. In Decision 97.02, the Board noted that "the Proponent's commitments vis-à-vis its future support for [R&D] activities are at best qualified; particularly inasmuch as there is no measure of the level of effort the Proponent intends to make in this regard (e.g., there are no expenditure estimates provided in the Benefits Plan)."[466] The Board also raised a concern about the commitment to E&T in the province and "encourage[d] the Proponent to consider ways it can support education and training generally in the Province, beyond simply using local organizations and facilities to deliver the training needs of the Development."[467] In summary, the Board stated as follows:

> It is the Board's overall assessment, however, that the Plan does not fully satisfy the statutory requirement that the Benefits Plan contain provisions intended to ensure that expenditures are made

[462] Claimants' Memorial, ¶¶ 81, 211.

[463] **CA-10**, Accord, s. 55.

[464] **CA-11**, Federal Accord Act, s. 45(3)(c).

[465] **CA-11**, Federal Accord Act, s. 151.1(1).

[466] **CE-57**, Terra Nova Decision 97.02, s. 3.5.1, p. 23.

[467] **CE-57**, Terra Nova Decision 97.02, s. 3.5.2, p. 23.

> on research and development and education and training in the Province.[468]

293. The Board went on to state that to enable it to "provide a framework for monitoring" the R&D and E&T expenditures, the proponents submit yearly reports that describe expenditure estimates for a three year-period as well as on actual expenditures for the preceding years.[469]

294. The Board stated explicitly:

> The Board also has an obligation as the regulator to ensure that the Proponent's commitments are met. Accordingly, it will develop, in consultation with the Proponent...appropriate reporting formats for tracking employment and expenditures.[470]

295. Like the decision approving the Hibernia Benefits Plan, the decision approving the Terra Nova Benefits Plan explained that the Board expected the proponents to undertake a broad range of R&D.[471] For example, the Board endorsed the recommendation from the Environmental Panel that the proponents "fund basic research" to cover a broad range of off-shore related issues.[472] The Terra Nova proponents committed themselves to regularly forecast and report its R&D and E&T expenditures to ensure the Board could properly monitor the level of benefits achieved.[473] Such reports

[468] **CE-57**, Terra Nova Decision 97.02, s. 3.5.3, p. 24.

[469] *Id.*

[470] **CE-57**, Terra Nova Decision 97.02, s. 1.2, p. 2.

[471] This was consistent with the 1988 Development Guidelines, which required the Claimants to report the details of their proposed "offshore-related" R&D and E&T projects and programs, including expenditures, "to ensure that the principles of the Benefits Plan are being followed and its commitments are being met." **RE-9**, 1988 Development Application Guidelines, ss. 5.2.4, 5.2.5, 5.5.2.

[472] **CE-57**, Terra Nova Decision 97.02, s. 3.5.1, p. 23. Recommendation 51 of the Environmental Panel stated ("The Panel recommends that the Board require operators of offshore oil projects to fund basic research. This initiave should include support of the Department of Fisheries and Oceans to conduct basic research on the mechanisms and processes by which chemicals in produced water may have impacts on the biological community. Also, support for research on cumulative and sub-lethal effects should be included."). **CE-57**, Terra Nova Decision 97.02, p. 66.

[473] **RE-12**, Terra Nova Benefits Plan, pp. 9-2, 9-4; **CE-57**, Terra Nova Decision 97.02, s. 1.2. p. 2.

were subject to audit by the Board.[474] The Claimants subsequently demonstrated their understanding that they had a broad-based obligation to spend on R&D and E&T, and not just on activities directly applicable to the project.[475]

296. In sum, the actions of the Board both before and after the Terra Nova Benefits Plan was approved cannot objectively be understood as having generated any expectations on the part of the Claimants that it would have the right to determine themselves the necessary amount of spending on R&D and E&T.

4. Summary

297. The Claimants' attempt to characterize the Board as having repudiated assurances made to the Claimants to induce their investments in Hibernia and Terra Nova is unavailing. The Claimants understood from the onset of the projects that their R&D and E&T expenditure reports would be scrutinized by the Board for the purpose of determining if they were fulfilling their benefits committments, and that the Board had the mandate to "approve" those expenditures and "monitor" the level of efforts and benefits achieved. It is an unreasonable expectation for the Claimants to believe that the Board could not step in with a minimum expenditure benchmark should it consider the Claimants' reporting insufficient to fulfil their obligations under the Accord Acts and decisions approving the Benefits Plans.

298. As Justice Barry of the Court of Appeal held:

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[474] **CE-57**, Terra Nova Decision 97.02, s. 3.6, p. 24.

[475] **CE-81**, Terra Nova Development, Canada-Newfoundland Benefits Annual Report on Research and Development, Submitted to the Canada-Newfoundland Offshore Petroleum Board (Mar. 1999), p. 8 ("The Proponents will continue to support technically worthy research and development activities and programs in the province where the results of such activities and programs have application to the Terra Nova Development *and/or to the development of an offshore oil industry in the province*") (emphasis added); **CE-82**, Terra Nova Development, Canada-Newfoundland Benefits Annual Report on Education and Training, Submitted to the Canada-Newfoundland Offshore Petroleum Board (Mar. 1999), p. 3 ("[i]n addition to implementing training initiatives aimed at meeting the specific training requirements of the development, the Proponents also continue to work actively with Memorial University of Newfoundland, College of the North Atlantic and the Marine Institute in various areas *related to the furthering of opportunities for the establishment of offshore related skills in the province*) (emphasis added).

> *The decisions granting the appellants approval for their projects have not been fundamentally changed.* The Board reasonably interpreted its decisions. They approved the Hibernia and Terra Nova projects on condition that the Board have the authority to continuously monitor research and development expenditures and intervene by issuing guidelines requiring higher expenditures should the appellants' level of expenditures fall below that which the Board considered appropriate. These were the rules of the game when development approvals issued. The same rules apply today.[476]

299. There were no assurances given to the Claimants that the Board would not issue future guidelines on R&D and E&T expenditures, and the Claimants have not shown that they specifically relied on any assurances from the Board with respect thereto when they decided to invest in the Projects.[477] The evidence does not support the Claimants' subjective interpretation of the Accord, Accord Acts or the Hibernia or Terra Nova Benefits Plan approvals that they have the right to self-judge whether their R&D and E&T expenditures are consistent with the law.

F. Even if Article 1105 Requires a Stable Regulatory Environment, the Claimants Have Failed to Demonstrate Any Breach

300. As noted above, it is not clear if the Claimants consider the obligation to provide a stable regulatory environment to be in addition to, or part of, the alleged rule of custom that protects the legitimate expectations of foreign investors. In any event, the Claimants

[476] **CA-53**, Court of Appeal Decision, ¶ 135, emphasis added.

[477] Indeed, the R&D and E&T provisions were (and continue to be) a tiny portion of the overall value of the investment and likely a secondary consideration for the Claimants within the broader scheme of their billion-dollar Hibernia and Terra Nova investments. Further, it has not even been established that the Claimant Murphy, which bought a stake in the Hibernia project in 1993, had any expectations with respect to R&D and E&T expenditures. Cal Buchanan suggests that Murphy has "minimal information in its possession about R&D activities undertaken in connection with the Hibernia and Terra Nova projects." Buchanan Statement, ¶ 10. The Claimants have not even established that the doctrine of legitimate expectations applies to a minority shareholder who made an investment subsequent to the alleged government representations relied on by an original investor. This is a different situation from that in the arbitral cases on which the Claimants rely.

have failed to demonstrate that the Guidelines "represent a fundamental shift in [the] regulatory framework."[478]

301. There was no fundamental repudiation of the regulatory framework or agreements the Claimants had with the Board. The Accord, Accord Acts, Hibernia Decision 86.01 and Terra Nova Decision 97.02 remain intact. The power and authority of the Board to issue the Guidelines existed at the beginning of the Projects, and remains unchanged today. The Guidelines merely set out the Board's expectations for the spending obligations that the Claimants have always had.

302. Moreover, Canadian courts have already confirmed that the Board acted consistent with the regulatory framework. NAFTA tribunals have repeatedly confirmed that, when considering the claim for a breach of Article 1105, they have no authority to review the decisions of domestic courts.[479] The Claimants have no basis to complain that the Guidelines fundamentally altered the regulatory framework.

[478] Claimants' Memorial, ¶ 212.

[479] **RA-3**, *Azinian*, ¶ 99 ("The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seised has plenary appeallate jurisdiction. This is not true generally, and it is not true for NAFTA. *What must be shown is that the court decision itself constitutes a violation of the treaty.*"); **CA-36**, *Mondev*, ¶ 136 ("On the approach adopted by Mondev, NAFTA tribunals would turn into courts of appeal, which is not their role."); **CA-33**, *Thunderbird*, ¶ 125 ("It is not the Tribunal's function to act as a court of appeal or review in relation to the Mexican judicial system regarding the subject matter of the present claims...").

V. THE CLAIM FOR COMPENSATION IS UNFOUNDED

303. Even if Canada has breached the NAFTA, which it has not, the Claimants are not entitled to the compensation claimed. Fundamentally, it is premature to calculate damages. The calculation depends on an important pending decision of the Board and the result of Canada's outstanding document requests. Consequently, Canada has not presented an alternative calculation of damages in this Counter Memorial. Instead, Canada outlines the methodology it will follow in the calculation of those damages. Canada will provide that alternative calculation in its Rejoinder after the Board has had an opportunity to issue its pending decision and the Tribunal has ruled on Canada's application concerning the production of documents.

304. However, even at this premature stage, there is sufficient information to conclude that the claim for compensation is unfounded because:

a) the claim for damages from 2004 to 2008 is exaggerated;
b) damages from 2009 to 2036 cannot be awarded; and
c) even if damages from 2009 to 2036 could be awarded, the Claimants' calculation of those damages is exaggerated.

A. The Claim for Damages from 2004 to 2008 is Exaggerated

1. The Claim for Damages From 2004 to 2008

305. The Claimants allege damages of approximately $30.284 million between 2004 and 2008. The Claimants calculate these damages as the difference between:

- the amount of R&D and E&T necessary to comply with the Guidelines; and
- the amount that the Claimants would have otherwise spent on R&D and E&T under the Guidelines in the ordinary course of business.[480]

[480] Claimants' Memorial, ¶ 216.

306. To calculate this first element, the Claimants rely upon letters issued by the Board detailing the level of R&D and E&T expenditures required under the Guidelines for 2004 to 2008, which are:

Guidelines Expenditure Requirements for 2004-2008[481]			
	Hibernia	Terra Nova	Total
Mobil Investments Canada Inc.	$22.035 million	$7.489 million	$29.524 million
Murphy Oil Corporation	$4.324 million	$4.085 million	$8.409 million
Total	$26.359 million	$11.574 million	$37.933 million

307. From this amount the Claimants subtract what they allege they spent on R&D and E&T in the ordinary course of business. To quantify this amount, the Claimants rely on the definition of R&D under section 248(1) of Canada's *Income Tax Act*, which is used by the Canada Revenue Agency ("CRA") when determining which R&D undertaken in Canada will qualify for an SR&ED tax credit.[482] The Claimants allege that these expenditures are:

[481] **CE-116**, Letter from F. Smyth, CNLOPB, to P. Sacuta, HMDC (Feb. 26, 2009); **CE-117**, Letter from F. Smyth, CNLOPB, to G. Vokey, Petro-Canada (Mar. 3, 2009).

[482] Claimants' Memorial, ¶ 218.

Alleged R&D and E&T in the Ordinary Course of Business for 2004-2008[483]			
	Hibernia	Terra Nova	Total
Mobil Investments Canada Inc.	[redacted]	[redacted]	[redacted]
Murphy Oil Corporation	[redacted]	[redacted]	[redacted]
Total	[redacted]	[redacted]	$7.754 million

308. Deducting these R&D and E&T expenditures from the expenditures required under the Guidelines produces a shortfall. The Claimants allege their damage for the years 2004 to 2008 is this shortfall:

Alleged Damages for 2004-2008[484]			
	Hibernia	Terra Nova	Total
Mobil Investments Canada Inc.	[redacted]	[redacted]	[redacted]
Murphy Oil	[redacted]	[redacted]	[redacted]

[483] Figures are the Claimants' respective shares of the total "R&D Expenditures in the Ordinary Course" for 2004 to 2008 from the report of the Claimants' expert Howard Rosen ("Rosen Report"), Schedules 2 and 3.

[484] Figures for Hibernia are calculated by taking Rosen Report's Schedule 2 "Incremental Spending, Cumulative at Beginning of Year" for 2009 of $[redacted] and applying the Claimants' respective ownership percentages (33.125% for Mobil and 6.5% for Murphy Oil). Figures for Terra Nova are calculated by taking Rosen Report's Schedule 3 "Incremental Spending, Cumulative at Beginning of Year" for 2009 of [redacted] and applying the Claimants' respective ownership percentages (22% for Mobil and 12% for Murphy Oil). These figures are slightly different than the amounts claimed because the Claimants assume these amounts will be paid mid-2010 and thus discount them from mid-2010 to mid-2009.

Corporation			
Total	[redacted]	[redacted]	$30.284 million

2. The Calculation of Damages From 2004 to 2008 is Premature

309. Up to this point, the Claimants have incurred no damages because they have made no payments under the Guidelines.[485] While the Guidelines have operated since 2004, they were not enforced by the Board until their legality was definitively confirmed by Canadian courts in late 2008.[486] After this confirmation, the Board turned to consider the Claimants' eligible R&D and E&T expenditures between 2004 and 2008. The Board received submissions from the Claimants on their expenditures on September 30, 2009.[487] The decision of the Board regarding the eligibility of the Claimants' past expenditures is pending. The decision of the Board is crucial to identifying the Claimants' shortfall, if any, from 2004 to 2008.

310. To calculate their shortfall, the Claimants have predicted the decision of the Board. Specifically, they have predicted that the Board will accept only those expenditures that have been approved by the CRA for the SR&ED credit. However, Canada has not made a prediction that will inevitably need to be abandoned when the Board issues its decision. Until the Board issues its decision, it is premature to calculate the Claimants' shortfall from 2004 until 2008.

[485] Walck Report, ¶ 11; Rosen Report, ¶ 43 ("The Incremental Spending does not represent an economic loss to the Claimants until the cash outlays are ultimately made.").

[486] See Counter Memorial, ¶ 103.

[487] **RE-44**, Hibernia Report, R&D and E&T Expenditure Requirements (Sep. 30, 2009); **RE-45**, Terra Nova Development: Research and Development Education and Training Report Submitted to the CNLOPB (Oct. 1, 2009).

311. Nonetheless, even at this premature stage, there is sufficient information to conclude that the claim for compensation between 2004 and 2008 is exaggerated because the Claimants:

- inflate their shortfall by understating their R&D and E&T expenditures in the ordinary course of business between 2004 and 2008;
- fail to deduct from their shortfall SR&ED tax credits they may receive from additional R&D spending;
- fail to deduct from their shortfall royalty deductions they may receive from additional R&D and E&T spending; and
- fail to deduct from their shortfall other benefits they will receive from additional R&D and E&T spending.

3. The Claimants Inflate Their Shortfall by Understating Their R&D and E&T in the Ordinary Course of Business Between 2004 and 2008

312. The claim for damages between 2004 and 2008 is the shortfall between the Claimants' obligations under the Guidelines and what the Claimants would have otherwise spent on R&D and E&T in the absence of the Guidelines. The Claimants inflate the shortfall by understating what they would have otherwise spent in the absence of the Guidelines. They understate this expenditure in two ways.

313. First, the Claimants calculate their R&D expenditures by reference to the definition of R&D used for the SR&ED credit, which is narrower than that employed by the Guidelines. The Guidelines specifically note that R&D "includes, but *is not limited to* Section 248(1) of the *Income Tax Act*."[488] Thus, the Claimants have made other expenditures in the normal course of business which have not been approved by the CRA but may nevertheless qualify under the Guidelines.[489] Such expenditures should not be

[488] **CE-1**, Guidelines, s. 3.3, emphasis added.

[489] Walck Report, ¶¶ 112-118, 121.

counted as damages caused by the Guidelines. By using an overly narrow definition of R&D, the Claimants understate their R&D expenditures in the ordinary course of business and, thus, inflate their shortfall.

314. Second, the Claimants' figures on R&D and E&T expenditures in the ordinary course of business are contradicted by the figures they submitted to the Board. As explained above,[490] on September 30, 2009, the Claimants submitted to the Board R&D and E&T expenditures made between 2004 and 2008 that they believe qualify as R&D and E&T expenditures under the Guidelines. The figures presented to the Board are significantly higher than those submitted to this Tribunal:

R&D and E&T Expenditures Submitted by the Claimants to the Board[491]			
	Hibernia	Terra Nova	Total
Mobil Investments Canada Inc.	[redacted]	[redacted]	[redacted]
Murphy Oil Corporation	[redacted]	[redacted]	[redacted]
Total	[redacted]	[redacted]	[redacted]

315. Relying on the expenditures submitted to the Board, rather than the expenditures submitted to this Tribunal, significantly affects the calculation of damages between 2004 and 2008. For Hibernia, if the Board accepts all of the Claimants' submissions, [redacted]

[490] Counter Memorial ¶ 309.

[491] The figures in the table are determined by multiplying ownership interests in the projects by the R&D and E&T expenditures between 2004 and 2008 submitted to the Board. Compare these figures submitted to the Board with the figures that the Claimants submitted to the Tribunal identified at Counter Memorial, ¶ 307.

[redacted][492] [redacted]

[redacted][493] For Terra Nova, if the Board accepts all of the Claimants' submissions, [redacted]

[redacted][494] [redacted][495]

316. While it is premature to calculate the Claimants' R&D and E&T spending in the ordinary course of business between 2004 and 2008 until the Board issues its decision, the Claimants have apparently understated those expenditures and inflated their shortfall by relying on different expenditures from those that they submitted to the Board.

4. The Claimants Fail to Deduct From Their Shortfall SR&ED Tax Credits They May Receive From Additional R&D Spending

317. Once the shortfall in the Claimants' R&D and E&T expenditures between 2004 and 2008 is calculated, the Claimants will need to fill that shortfall through additional expenditures. The Claimants refer to these additional expenditures as their "Incremental Spending."[496] The Claimants may fill their shortfall through R&D. These additional R&D expenditures may, in turn, generate tax credits under the SR&ED program.

318. The SR&ED program is a tax incentive program that encourages Canadian businesses to conduct R&D in Canada.[497] The federal government provides an Investment Tax Credit of 20% for SR&ED expenditures.[498] In addition to the federal

[492] Walck Report, ¶ 120.

[493] Smyth Statement, ¶ 37.

[494] Walck Report, ¶ 123.

[495] Counter Memorial, ¶ 308.

[496] Rosen Report, ¶¶ 41-43.

[497] Further information is available online at: http://www.cra-arc.gc.ca/sred/.

[498] **CE-142.** Canada Revenue Agency, What is the SR&ED Program?

component, the provincial government provides a credit of 15% for eligible SR&ED expenditures.[499] Hence, SR&ED tax credits from additional R&D spending could be significant.[500]

319. It is premature to calculate the SR&ED tax credits because the Board must first determine the Claimants' shortfall in R&D and E&T spending between 2004 and 2008. Once that shortfall is determined, the Claimants then need to identify their expenditures to fill the shortfall. Only then can the SR&ED tax credits be reasonably determined. For example, if the Claimants fill the shortfall by spending entirely on R&D rather than E&T, then their SR&ED credits will likely be significant. While it is premature to calculate the SR&ED tax credits, the Claimants have not deducted any such credits. Hence, the Claimants have exaggerated their claim for damages from 2004 to 2008.

5. The Claimants Fail to Deduct from their Shortfall Royalty Deductions They May Receive From Additional R&D and E&T Spending

320. Additional R&D or E&T spending to fill their shortfall may provide the Claimants with reductions to their royalty payments. Royalty payments are a percentage of revenue the Claimants pay to the province.[501] [redacted] [502] [redacted] [503] [redacted] Thus, R&D and E&T expenditures can reduce the revenue base on which

[499] **RA-17**, *Income Tax Act*, S.N.L. 2000, c. I-1.1, s. 42.

[500] Walck Report, ¶ 101.

[501] **RE-49,** Government of NL, Hibernia Project Royalty Regime; **RE-50,** Government of NL, Terra Nova Project Royalty Regime.

[502] **RE-19,** Hibernia Development Project Royalty Agreement, Articles 19, 20 and 21; **RE-26,** *Newfoundland and Labrador Regulation 71/03* (enacted under the *Petroleum and Natural Gas Act*, RSNL 1990 c. P-10), ss. 9, 10, 11, 12, 73, 74, 76.

[503] **RE-19**, Hibernia Development Project Royalty Agreement, Article 29.1; **RE-26,** *Newfoundland and Labrador Regulation 71/03*, s. 63(1).

royalties are calculated and, therefore, reduce the royalty. Royalty deductions resulting from expenditures under the Guidelines are potentially significant. For example, expenditures of $1 million could save the Claimants more than $425,000 in royalty payments.

321. It is premature to calculate the royalty benefit. Before the benefit can be calculated, the Board must determine the Claimants' shortfall in R&D and E&T spending between 2004 and 2008. The Claimants then need to identify their expenditures to fill this shortfall. Only then can the royalty deductions be determined. For example, if the Claimants fill the entire shortfall through expenditures necessary for the projects, the royalty deductions will likely be significant. While it is premature to calculate the royalty deductions, the Claimants have not deducted any such benefits. Hence, the Claimants have exaggerated their claim for damages from 2004 to 2008.

6. The Claimants Fail to Deduct From Their Shortfall Other Benefits They Will Receive From Additional R&D and E&T Spending

322. When filling any shortfall in their R&D and E&T expenditures between 2004 and 2008, the Claimants will undertake expenditures which will benefit them. The Claimants' witness, Paul Phelan, notes that "we are actively looking for opportunities to undertake work that could at least be of *some benefit to the project* ..."[504] Indeed, the NL Court of Appeal rejected the argument that the Guidelines were a tax precisely because the Claimants will benefit from their expenditures under them.[505]

323. To fill the shortfall the Claimants may shift existing projects to NL from other locations. The Claimants may also undertake in NL projects which it would have

[504] Phelan Statement, ¶ 29(a), emphasis added. See also Ringvee Statement, ¶ 10 ("Through the industry Task Force, we are seeking to identify a few large joint industry R&D projects as a key part of our plan to close the gap between actual R&D spending needs and the Guidelines requirements. In doing so, *we are making every effort to identify investment opportunities that provide value to the project participants*") (emphasis added).

[505] **CA-53**, Court of Appeal Decision, ¶ 78. Justice Welsh ("Appropriate research and development projects would be chosen, and undertaken, by the company. The projects, and consequently expended funds, would, therefore, be under the supervision and control of, and having direct or indirect benefit to, the company.")

undertaken elsewhere. If the Claimants do fill any shortfall through such projects, then the Claimants will save the cost of conducting the project in the old location. These saved costs resulting from the additional R&D and E&T expenditures must be deducted from any shortfall.

324. It is premature to calculate these benefits and saved costs because they depend on the shortfall identified by the Board and, in turn, the nature of the R&D and E&T expenditures which the Claimants identify to fill that shortfall. For example, if the Claimants decide to fill the shortfall entirely through R&D projects which they shift to NL from other locations, the cost savings to them will be significant. While the precise nature of these benefits and cost savings cannot be calculated now, the Claimants have failed to account for them. Hence, the Claimants have exaggerated their claim for damages from 2004 to 2008.

B. The Claim for Damages From 2009 to 2036 is Unfounded

1. The Claim for Damages From 2009 to 2036

325. In addition to claiming for damages from 2004 to 2008, the Claimants also claim for damages from 2009 until the end of the projects (2036 for Hibernia and 2018 for Terra Nova). To calculate these damages, the Claimants predict the damages they will allegedly suffer in the future and then discount those alleged future damages to their present value using a risk-free rate of less than 3%:

Alleged Damages From 2009 to 2036[506]			
	Hibernia	Terra Nova	Total

[506] Figures are obtained by applying the 2010 present value factor to Rosen Report's "Incremental Spending Requirement, Cumulative Balance" for 2004 to 2008, subtracting this amount from his total "Present Value of Net Incremental Spending" for the project and applying the Claimants' respective ownership percentages. For example, for Mobil's share of the Hibernia damages, the calculation (using figures from Rosen Report's Schedule 2 would be: [$108.98 million - ($50.04 million x 0.9915)] x 33.125% = $19.665 million.

Mobil Investments Canada Inc.	$19.665 million	$7.672 million	$27.337 million
Murphy Oil Corporation	$3.859 million	$4.185 million	$8.044 million
Total	$23.524 million	$11.857 million	$35.381 million

326. The claim for damages from 2009 until 2036 is *not* a claim for damages which the Claimants have incurred and which requires the calculation of lost future profits. For example, this is *not* a claim for the past expropriation of an investment that requires the calculation of the investment's future profits to determine the value of the investment on the date of expropriation. In that circumstance, the damages are incurred on the date of expropriation, which is in the past.

327. In contrast, the Claimants seek compensation for damages *not yet incurred.* They assert that they will incur damages each future year until 2036 through the expenditures which they will be required to make under the Guidelines. This is a claim for damages which the Claimants assert they will incur in the future. Such damages cannot be awarded because:

a) the award of damages not yet incurred is inconsistent with the NAFTA;

b) the award of damages not yet incurred is inconsistent with international principles of compensation; and

c) such damages are speculative.

2. Damages From 2009 to 2036 Cannot be Awarded

a) An Award of Damages Not Yet Incurred is Inconsistent with the NAFTA

328. Article 1116 is clear that a tribunal may only award compensation for damages already incurred:

> An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under [Chapter Eleven]...and that the investor *has incurred loss* or damage by reason of, or arising out of, that breach.[507]

329. *Feldman v. Mexico* relied on Article 1116 when considering the damages which can be awarded for breaches of Chapter 11 of the NAFTA other than the expropriation provision. The tribunal concluded that only losses actually incurred can be awarded:

> [W]hat is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach...[I]f loss or damage is the requirement for the submission of a claim, it arguably follows that the Tribunal may direct compensation in the amount of the *loss or damage actually incurred.*[508]

330. Similarly, in *UPS v. Canada* the NAFTA Chapter 11 tribunal refused to award damages for conduct occurring outside the time period subject to the tribunal's jurisdiction:

> [A] claimant must not only show that it has persuasive evidence of damage from the actions alleged to constitute breaches of NAFTA obligations but also that the damage occurred as a consequence of the breaching Party's conduct within the specific time period subject to the Tribunal's jurisdiction...[W]here a continuing course of conduct is at issue, the damage must flow from conduct that occurred within the three-year time period preceding the complaint.[509]

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[507] **CA-3**, NAFTA Chapter 11, Article 1116, emphasis added.

[508] **CA-29**, *Marvin Roy Feldman v. United Mexican States*, Award (ICSID ARB(AF)/99/1) December 16, 2002, ¶ 194, emphasis added. This reasoning was adopted in *LG&E Energy Corp. v. The Argentine Republic*, Award (ICSID ARB/02/1) July 25, 2007, ¶ 44 (hereinafter "*LG&E*").

[509] **RA-71**, *UPS*, ¶ 38.

331. Thus, Article 1116 of the NAFTA limits the Tribunal to the award of compensation for damages already incurred.

b) An Award of Damages Not Yet Incurred is Inconsistent with International Principles of Compensation

332. The clear wording of Article 1116 of the NAFTA is sufficient to dispense with the claim for damages not yet incurred. However, such a claim is also inconsistent with international principles of compensation. International tribunals have held that they may only award compensation for damages already incurred.

333. The seminal decision on compensation in international law is the decision of the PCIJ in *Chorzow Factory*.[510] In that case, the PCIJ said that an award for compensation is an award for "loss sustained."[511]

334. This principle that a tribunal may only award compensation for damages already incurred has been applied by subsequent tribunals. For example, the Umpire in the *Lusitania* case noted that "[t]he fundamental concept of 'damages' is ... reparation for *a loss suffered.*"[512] More recently, the *LG&E* tribunal said:

> [T]he issue that the tribunal has to address is that of the identification of the "*actual loss*" suffered by the investor "*as a result*" of Argentina's conduct.[513]

[510] **CA-28**, *Factory at Chorzow*, 1928 P.C.I.J. (Ser. A) No. 17, September 13, 1928 (hereinafter "*Chorzow*"). Claimants' Memorial, ¶ 215. See also **CA-15**, *ADC Affiliate Ltd and ADC & ADMC Management Ltd v Hungary*, Final Award on Jurisdiction, Merits and Damages (ICSID ARB/03/16) October 2, 2006, ¶¶ 484, 493.

[511] **CA-28**, *Chorzow*, p. 47 ("Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it—such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.")

[512] **RA-27**, *Opinion in the Lusitania Cases*, November 1, 1923, in United Nations, *Reports of International Arbitral Awards* (UNRIAA), vol. VII (Sales No. 1956.V.5), p. 39, emphasis added.

[513] **RA-25**, *LG&E*, ¶ 45, emphasis in original.

335. The decisions in *LG&E*, *Lusitania* and *Chorzow* that an international tribunal may only award compensation for damages already incurred are reflected in the commentary to the International Law Commission Articles on State Responsibility. Article 36 recognizes the rule that "[t]he State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby ...." The commentary to the Article provides that:

> the function of compensation is to address the *actual losses incurred as a result* of the internationally wrongful act... Monetary compensation is intended to offset, as far as may be, *the damage suffered* by the injured State as a result of the breach.[514]

336. This commentary to Article 36 reflects the principle that an international tribunal may only award compensation for damages already incurred. Claims for damages not yet incurred were rejected by two recent investment treaty tribunals.

337. In *LG&E v. Argentina*, the claimants challenged Argentine legislation which was still in effect at the time of the award. The claimants claimed for both dividends lost in the past, as well as dividends which would be lost in the future through the continued application of that legislation.[515] The claim for damages not yet incurred was rejected by the tribunal because "future loss to the Claimants is uncertain and any attempt to calculate it is speculative."[516] The tribunal acknowledged that:

> Claimants' arguments that they would have to bear the risk and uncertainty resulting from Argentina's conduct and the burden to

[514] **RA-16**, Responsibility of States for Internationally Wrongful Acts 2001, *Report of the International Law* Commission, Fifty-Third Session (23 April-1 June and 2 July-10 August 2001), Supp. No. 10 (A/56/10), United Nations, New York, Commentary, Article 36, p. 99, ¶ 4, emphasis added ("ILC Articles"). See also **RA-8A** James Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge University Press: 2002), p. 219 ("[T]he function of compensation is to address the *actual losses incurred as a result* of the internationally wrongful act. In other words, the function of article 36 is *purely compensatory*, as its title indicates. Compensation corresponds to the financially assessable damage *suffered* by the injured [party] ... Monetary compensation is intended to offset, as far as may be, the damage *suffered* by the injured State as a result of the breach") (emphasis added).

[515] **RA-25**, *LG&E*, ¶¶ 65, 88.

[516] **RA-25**, *LG&E*, ¶ 90.

> seek periodic additional relief at great cost and expense are not entirely without merit. However, the Claimants have chosen to maintain their investments in Argentina ... The decision to maintain their investments in Argentina has its consequences: (i) the impact of Argentina's conduct on the value of investments has not crystallized and is subject to the changing regulatory environment and fluctuations of the stock market; (ii) lost future profits are uncertain and their calculation is speculative; and (iii) compensation could only be awarded for damages actually suffered and sufficiently proven.[517]

338. A claim for damages not yet incurred was also rejected in *Occidental Petroleum v. Ecuador*. The claim in that case arose when Ecuador stopped refunding Value-Added Tax ("VAT") paid by the claimant. The claimant claimed for both VAT payments, which had not been refunded, and future VAT payments, which were not yet due or paid. The tribunal dismissed the claim for future VAT payments:

> The Tribunal will not order the payment of compensation or a refund of amounts that are not due or paid. The Respondent has rightly cited to this effect the decision in *SPP* relying on the *Chorzow Factory* and *Amoco* to the extent that contingent and undeterminate damage cannot be awarded. OEPC's claim for US $ 121,300,000 on this count is therefore dismissed.[518]

339. Consequently, both the *Occidental* and *LG&E* tribunals rejected claims for damages not yet incurred. Such claims are inconsistent with international principles of compensation.

c) Damages From 2009 to 2036 Are Speculative

340. The rule that international tribunals only award compensation for damages already incurred stems from the principle that States are only obliged to compensate for damages that are sufficiently certain. This principle is widely recognized. In its seminal statement on reparation in *Factory at Chorzow*, the PCIJ recognized that "reparation must ... reestablish the situation which would, *in all probability*, have existed if that act had

[517] **RA-25**, *LG&E*, ¶ 96.

[518] **CA-39**, *Occidental Exploration and Production Company v Ecuador*, Award (LCIA Case No. UN 3467) July 1, 2004, ¶ 210.

not been committed."[519] Similarly, in *Amoco Finance Corp v. Iran*, the Iran–US Claims Tribunal observed that "[o]ne of the best settled rules of the law of international responsibility of States is that no reparation for speculative or uncertain damage can be awarded. This holds true for the existence of the damage and of its effect as well."[520] The International Law Commission drew from this jurisprudence to note that "Tribunals have been reluctant to provide compensation for claims with inherently speculative elements."[521]

341. Damages not yet incurred will always be uncertain. The alleged damages in this case are no different. Every element of the claim for damages from 2009 until 2036 is uncertain, including:

- the price of oil;
- oil production;
- the Statistics Canada benchmark;
- the development phase credit;
- R&D and E&T expenditures in the ordinary course of business;
- the SR&ED tax credit;
- royalty deductions;
- the benefits from additional R&D and E&T expenditures;
- the transfer of R&D and E&T projects to NL; and
- the Guidelines, themselves.

[519] **CA-28**, *Chorzow*, p. 47, emphasis added.

[520] **CA-17**, *AMOCO*, ¶ 238, emphasis added (hereinafter "*AMOCO*").

[521] **RA-16**, ILC Articles, p. 104, ¶ 27.

i) The Price of Oil is Uncertain

342. The Claimants make annual predictions of the price of oil 27 years into the future. These predictions are highly speculative and cannot be used as a basis for compensation. The *Amoco International Finance Corp v. Iran* tribunal stated:

> The element of speculation in a short–term projection is rather limited, although unexpected events can make it turn out to be wrong. The speculative element rapidly increases with the number of years to which a projection relates. It is well known, and certainly taken into account by investors, that if it applies to a rather distant future a projection is almost purely speculative, even if it is done by the most serious and experienced forecasting firms, *especially if it relates to such a volatile factor as oil prices*. Such projections can be useful indications for a prospective investor, who understands how far it can rely on them and accepts the risks associated with them; they certainly cannot be used by a tribunal as the measure of a fair compensation.[522]

343. The *Amoco* tribunal applied these principles to deny a claim for future profits.[523]

344. Peter Davies, who is the former Chief Economist for BP, confirms that oil price forecasts are unreliable and uncertain. He concludes that "[n]o oil price forecaster has been able to generate reliable and meaningful forecasts with any degree of certainty."[524]

345. The reasons for his conclusion include:

- oil demand trends are difficult to forecast because they are influenced by macroeconomic forces (such as the recent recession) and political measures such as taxes and environmental policies;[525]

[522] **CA-17**, *AMOCO*, ¶ 239, emphasis added. The Claimants' forecast is better used by a prospective investor than as a base for fair compensation. It was made by the Claimants' expert in the ordinary course of business and "is no different from [the expert's] forecasts for corporate clients." (Claimants' Memorial, ¶ 218) The Claimants also recognize the volatility of oil prices through the statement of their witness, Paul Phelan, ¶ 33 that oil prices can "fall unexpectedly" and "increase significantly."

[523] **CA-17**, *AMOCO*, ¶ 240.

[524] Davies Report, ¶ 61.

[525] *Id.*, ¶¶ 12-16.

- oil supply trends are difficult to forecast partly because the rate of global depletion is unknown;[526]

- the oil market is imperfectly competitive as a result of the actions and operations of the OPEC cartel;[527]

- oil is a "political commodity" meaning that political factors and oil policies in both producing and consuming countries affect the price of oil;[528] and

- oil is a "financial commodity" and variable investment in the resource as an asset can affect oil price dynamics in unpredictable ways.[529]

346. Some of these same reasons were relied on by the tribunal in *Amoco* when it dismissed the forecast of future oil prices as too speculative:

> [I]t is well known that oil prices have demonstrated a great instability. Independently of the fluctuations of the free market, decisions relating to fixed prices or to the volume of production, taken in the past by the big oil companies, or more recently by OPEC or other producing countries, have been responsible for these price variations. The difficulties and risks of error inherent in every price forecast are therefore considerably aggravated. A clear illustration of this situation is provided by the discrepancies which can be observed between the oil price forecasts used in the Claimant's expert study and the actual evolution of prices from 1979 to 1987.[530]

347. Hence, the future price of oil is too uncertain to be used as a basis for an award of damages not yet incurred.

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[526] *Id.*, ¶¶ 17-20.

[527] *Id.*, ¶¶ 24-29.

[528] *Id.*, ¶¶ 30-33.

[529] *Id.*, ¶¶ 34-35.

[530] **CA-17**, *AMOCO*, ¶ 237.

348. The Claimants' forecast does not provide that missing certainty. In fact, the Claimants have refused to produce the documents used to generate that forecast and have refused to provide the past predictions of ESAI, the company on whose forecast they rely.[531] Moreover, the information that the Claimants have revealed about their forecast demonstrates that it:

- relies on uncertain predictions of OPEC's future spare capacity, which in itself is an inappropriate forecasting tool;[532]
- was generated without reference to historical oil price experience;[533]
- does not contain explicit assumptions about critical political drivers of oil markets;[534] and
- is not consistent with a world moving towards a path to a sustainable climate.[535]

349. The Claimants seek to address the uncertainty of oil price forecasts by arguing that their forecast is conservative.[536] However, Peter Davies explains that ESAI's forecast is not conservative.[537] For example, he explains that the forecast is consistent with the highest forecasts published by the U.S. Energy Information Administration.[538]

350. The uncertainty in the future price of oil significantly impacts the calculation of the Claimants' alleged loss. The Claimants calculate total future (2009-2036) damages of

[531] Redfern Schedule, October 6, 2009, pp. 36-43.

[532] Davies Report, ¶¶ 49-54.

[533] *Id.*, ¶¶ 55-56.

[534] *Id.*, ¶ 57.

[535] *Id.*, ¶¶ 58-59.

[536] Claimants' Memorial, ¶ 218.

[537] Davies Report, ¶¶ 42-45.

[538] *Id.*, ¶ 43.

$35.381 million.[539] Applying the Claimants' damages model, and assuming all other elements in the Claimants' damages prediction are correct, a modest 10% increase or decrease in the future price of oil will have a 17.1% impact on the calculation of future damages.[540] Historic oil prices, however, have fluctuated far more than 10%. At times, the price of oil has changed by more than 100% in less than two years.[541]

351. The uncertainty of the Claimants' forecast is further exacerbated by the uncertainty of exchange rates. The Claimants predict the price of oil in U.S. dollars and then convert those prices to Canadian dollars to complete their calculation. For 2009 to 2013, the Claimants rely on a forecast of exchange rates from the website Economist.com.[542] These rates range from $1.03 to $1.20. From 2014 until 2036, the Claimants assume an exchange rate of $1.04.[543] However, the future exchange rate is uncertain. For example, the Claimants predicted a rate of $1.20 for 2009 but the current exchange rate is $1.05.[544] Moreover, there is evidence that the Canadian dollar will strengthen further against the U.S. dollar.[545]

352. Once again, the uncertainty over future exchange rates significantly impacts the calculation of the Claimants' alleged loss. Relying on the Claimants' model and assuming all other elements in the Claimants' damages prediction are correct, including future oil prices, increasing or decreasing the exchange rate by a modest ten cents will change the calculation of future damages by 16%.[546]

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[539] Counter Memorial, ¶ 325.

[540] Walck Report, ¶ 72.

[541] *Id.*, ¶¶ 70, 72.

[542] Rosen Report, Exhibit 9.

[543] *Id.*, Schedule 2, note 3 and Schedule 3, note 3.

[544] Walck Report, ¶ 80.

[545] *Id.*, ¶¶ 76-78.

[546] Walck Report, ¶ 80.

ii) Oil Production is Uncertain

353. The amount of R&D and E&T spending under the Guidelines is determined, in part, by the amount of oil produced in a given year. The Claimants rely on the projects' current production forecasts. However, the Claimants' future obligations under the Guidelines will not be based on these forecasts but on the actual amount of oil produced in a given year. Historically, there has been significant fluctuation between forecasted and actual oil production.[547]

354. These fluctuations occur partly through unforeseen problems. For example, the Terra Nova field produced no oil at all for several months in 2006 when equipment underwent maintenance.[548] Production in that year was less than a third of that forecast.[549] Production at Hibernia has also been disrupted. For example, in 2007 production decreased sharply when equipment malfunctioned.[550]

355. Actual oil production can thus vary significantly from what is forecasted. A minor variance can significantly impact the calculation of the Claimants' alleged future loss. Applying the Claimants' damages model and holding constant all other elements in their damages prediction, a 10% increase or decrease in the oil production forecast will have a 17.1% impact on the Claimants' calculation of future damages.[551]

iii) The Future Statistics Canada Benchmark is Uncertain

356. The Claimants' future obligations under the Guidelines will be based, in part, on the proportion of revenue spent on R&D by oil and gas extracting companies in Canada

[547] *Id.*, ¶¶ 47-49, 57, 61.

[548] **CE-59**, Decision 2005.03 Respecting the Amendment to the Terra Nova Development Plan, December 2005, s. 2.0.

[549] Walck Report, ¶ 56.

[550] *Id.*, ¶ 50, Exhibit 4.

[551] *Id.*, ¶¶ 64.

in a previous five-year period. In the future, the Claimants assume that this benchmark will be the average benchmark between 2004 and 2008, which is 0.39%.[552] However, between 2004 and 2009 the benchmark varied from 0.34% to 0.46%.[553]

357. The Claimants seek to address the uncertainty of the future benchmark by arguing that their forecasted benchmark is conservative. Specifically, the Claimants argue that the benchmark will increase over time as a result of R&D under the Guidelines and R&D needed to access as-yet unexploited reserves in Canada.[554] However, the Claimants provide no evidence to support their claim that either R&D expenditures under the Guidelines or accessing unexploited reserves in Canada will increase the benchmark. Until they provide such evidence, their assertions must be rejected.

358. Changes in the benchmark affect the expenditure requirement and, thus, the Claimants' alleged damages.[555] Applying the Claimants' model and assuming all other elements are constant, changing the future benchmark from 0.39% to 0.34% will decrease the Claimants' damages by 21.2%.[556]

iv) The Development Phase Credit is Uncertain

359. Under the Guidelines, the Claimants receive a credit for R&D and E&T expenditures during the development phase. This development phase credit ("DPC") is 0.5% of the total capital cost of the project.[557] The total DPC for Hibernia is $29 million and the total DPC for Terra Nova is $14 million.[558] For Terra Nova, the Claimants have

[552] Rosen Report, ¶ 36.

[553] Walck Report, ¶ 85.

[554] Claimants' Memorial, ¶ 218.

[555] *Id.*, fn. 400 ("As noted, even a minor variance in the benchmark can have a major impact on the R&D expenditure requirement...").

[556] Walck Report, ¶ 85.

[557] **CE-1**, Guidelines, s. 2.2.1.

[558] Walck Report, ¶ 86.

claimed the full amount of this credit against their expenditure obligations under the Guidelines until 2009.[559]

360. For Hibernia, the Claimants have assumed that they will claim this credit according to the formula provided in the Guidelines. Under that formula, the credit is pro-rated over the production phase of the projects in the same proportion as each year's production bears to the estimated total recoverable reserves.[560] In other words, the amount of DPC applied in a particular year is a function of the actual amount of oil produced that year and the then-current estimate of total recoverable oil over the life of the project.[561]

361. The effect of the DPC on the Claimants' damages for Hibernia is uncertain because the time at which the credit will be claimed is unknown. The Claimants have assumed that the remaining DPC balance will be spread over the remaining production life of the project, that is, from 2009 to 2036. However, they suggest that they may claim the credit up-front,[562] as they have with Terra Nova. The early application of the credit would significantly reduce the required R&D expenditure in the year the credit is granted and thereby affect the Claimants' total damages.[563]

362. Even if the Claimants pro-rate the remaining DPC over the production life of the Hibernia project, the amount of DPC in any year is contingent on actual oil produced and the estimated amount of total recoverable oil. As described above, actual oil production in the fields may vary from the Claimants' forecasts.[564] Moreoever, the estimated total recoverable oil may change in the future. For example, the estimated total for Hibernia

[559] Claimants' Memorial, ¶ 218; Rosen Report, ¶ 40.

[560] **CE-1**, Guidelines, s. 2.2.2.

[561] Walck Report, ¶¶ 88-94.

[562] Phelan Statement, ¶ 23.

[563] Walck Report, ¶ 97.

[564] Counter Memorial, ¶¶ 353-355; Walck Report, ¶¶ 47, 57.

increased from 865 million barrels in 2004 to 1,244 million barrels in 2005.[565] Conversely, the estimated total for Terra Nova has decreased.[566] Changes in either production or estimated total recoverable oil will affect the DPC and, thereby, the Claimants' assessment of their loss.[567]

v) Future R&D and E&T Expenditures in the Ordinary Course of Business are Uncertain

363. The Claimants estimate that their future annual R&D and E&T expenditures in the ordinary course of business will be a "normalized average"[568] of their expenditures from 2004 to 2008.[569] In other words, the Claimants project an average of their R&D and E&T expenditures for this period until 2036. The Claimants argue that using these past expenditures to project future expenditures is justified because the projects are in their production phase and R&D expenditures in the production phase are consistent.[570]

364. However, R&D expenditures during the production phase have been far from consistent. Since Hibernia started production in 1997, annual R&D expenditures for the project have ranged from [redacted] to [redacted][571] Terra Nova production phase R&D expenditures have ranged from [redacted] to [redacted].[572]

365. The Claimants also acknowledge the possibility of large R&D expenditures in the future:

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[565] Walck Report, ¶ 91.

[566] Walck Report, ¶ 94.

[567] *Id.*, ¶ 98.

[568] Claimants' Memorial, fn. 409.

[569] *Id.*, ¶ 218.

[570] *Id.*

[571] **CE-144**, Hibernia SR&ED Acceptance Chart (Jul. 29, 2009).

[572] **CE-145**, ExxonMobil Canada, Terra Nova SR&ED Claims Summary; **CE-146**, Murphy Oil Company Ltd., Terra Nova SR&ED Claims Summary.

> R&D may include new or improved technologies to increase oil recovery from the reservoir and enhanced systems to monitor and assess the integrity of project infrastructure. In addition, Hibernia has a large secondary reservoir known as the Ben Nevis Avalon ("BNA") that is largely undeveloped due to its technical complexity and associated economic risk. New technologies likely will be required to develop the BNA economically, although the nature and amount of any work that would qualify as R&D are currently unclear. As for Terra Nova, Claimants are aware that Petro-Canada, as operator, is planning to undertake research in the Province related to ship side valve isolation tooling. Petro-Canada may have additional R&D projects in mind of which Claimants are not aware.[573]

366. Moreover, the development of the AA and Hibernia South blocks, undeveloped reservoirs that are also part of the Hibernia field, may result in significant R&D and E&T that could be applied against the production phase expenditure requirements for Hibernia. Thus, the amount of future R&D and E&T expenditures "in the ordinary course of business" are far from certain and could be significantly different from those estimated by the Claimants.

vi) Benefits From Increased Future R&D and E&T Spending are Uncertain

367. The federal and provincial governments give tax credits for eligible SR&ED expenditure, as mentioned above.[574] Expenditure on R&D and E&T can also generate royalty deductions for the Claimants.[575] However, the Claimants themselves acknowledge that these credits and deductions are uncertain because it "remains to be seen how the Hibernia and Terra Nova interest owners will manage their Guidelines expenditure obligations."[576] Indeed, the Claimants' witness, Paul Phelan, notes that "[d]epending how we proceed, there may be different tax and royalty consequences that have yet to be fully

[573] Claimants' Memorial, ¶ 94. See also Graham Statement, ¶ 15 ("Less R&D is generally needed in the production phase of an asset's life cycle...Of course, like any rule, there are exceptions.")

[574] Counter Memorial, ¶ 318.

[575] *Id.*, ¶ 321.

[576] Claimants' Memorial, ¶ 220.

understood."[577] Equally uncertain are the benefits from the Claimants' increased future R&D and E&T spending as well as the cost savings to the Claimants from transferring to NL R&D and E&T projects previously conducted elsewhere.[578]

vii) The Continued Existence of the Guidelines in Their Present Form is Uncertain

368. The Claimants' entire claim for future loss is based on an assumption that the Guidelines will exist in their present form until 2036. However, any change to the Guidelines before 2036 completely changes the Claimants' future damages.

viii) Summary

369. The claim for damages from 2009 to 2036 rests on a series of highly uncertain elements. Even when keeping every other element constant, variations in individual elements significantly affect the future damages. When the uncertainties are compounded, the effect is overwhelming. For example, if the forecast of just three factors is marginally incorrect, then damages fall significantly: if oil production is 10% below forecast, oil prices are lower than the ESAI forecast by 10%, and the Canadian dollar strengthens by ten cents against the U.S. dollar, the Claimants' future damages fall by 48.7%.[579]

[577] Phelan Statement, ¶ 29.

[578] Counter Memorial, ¶ 323; Walck Report, ¶¶ 104-106.

[579] Walck Report, ¶ 154.

370. The Claimants allege that Canada must not be allowed to "benefit" from this uncertainty since it is the breaching party.[580] However, it is the Claimants which have the burden of proving their alleged losses.[581] The Claimants have failed to satisfy this burden regarding their claim for damages from 2009 to 2036 because it is overwhelmingly speculative.

3. Even if Damages From 2009 to 2036 Could be Awarded, the Claim for those Damages is Exaggerated

a) The Calculation of Damages From 2009 to 2036 is Premature

371. Even if damages from 2009 to 2036 could be awarded, it is premature to calculate those damages. The calculation of such damages largely depends on the pending decision of the Board. In that decision, the Board will decide which R&D and E&T expenditures of the Claimants from 2004 until 2008 in the ordinary course of business are eligible under the Guidelines. The Claimants have relied on a normalized average of these eligible expenditures to forecast their expenditures in the ordinary course of business until 2036. The Claimants then deduct these expenditures from the total predicted expenditures under the Guidelines to generate their future damages. Thus, the pending Board decision is crucial to the determination of the Claimants' future damages, just as it is crucial to the determination of their past damages.

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[580] Claimants' Memorial, fn. 415. In support of this argument the Claimants rely on a principle *nullus commodum capere de sua injuria propria*, or "No one shall take advantage of his own wrong." However, the cases on which the Claimants rely to support the principle illustrate that the principle does not apply to this circumstance. In each of the cases the 'wrong' was separate to the act alleged to breach international law and the 'wrong' directly caused the alleged 'advantage.' Neither of these elements is present here. The 'wrong' identified by the Claimants is the alleged breach itself and any uncertainty is directly caused by the Claimants' choice of R&D and E&T expenditures or the otherwise speculative nature of the Claimants' forecasts. Hence, Canada is not seeking to "take advantage of its own wrong." Moreover, the Claimants' refusal to account for uncertainty in this context is inconsistent with their reliance on uncertainty in another. Specifically, the Claimants refuse to reduce their damages to account for SR&ED credits and royalty deductions because the quantum is too uncertain (Rosen Report, ¶ 59). The Claimants cannot refuse to consider uncertain elements which would reduce their damages but rely on equally uncertain elements to inflate those damages.

[581] **RA-44,** *S.D. Myers v. Canada*, (UNCITRAL) Second Partial Award, October 21, 2002, ¶ 94.

372. However, once again, the Claimants have relied on their prediction of the Board's decision on which expenditures of the Claimants from 2004 until 2008 are eligible under the Guidelines. Once again, Canada has not made predictions which will need to be abandoned when the Board issues its pending decision. Until that decision is issued, the calculation of the Claimants' future damages is premature.

373. The calculation of damages from 2009 to 2036 is also premature because the Tribunal is yet to rule on Canada's request for documents concerning the calculation of those damages. For example, Canada asked the Tribunal to order the Claimants to produce documents which help indicate the appropriate rate by which the future damages should be discounted to the present. Until the Tribunal's decision it is premature to calculate that discount rate.

374. However, even at this premature stage, there is sufficient information to conclude that the claim for damages from 2009 to 2036 is exaggerated.

b) The Claim For Damages From 2009 to 2036 is Exaggerated

375. To determine the present value of their alleged future loss, the Claimants employ a discounted cash flow ("DCF") method. They employ this method in two basic steps. First, the Claimants estimate the damages that they will allegedly suffer in the future. Second, they discount those alleged future damages to calculate their present value. The Claimants exaggerate their damages by misapplying both steps.

376. The Claimants exaggerate their estimated future damages through the same means that they exaggerate their past damages. The claim for compensation is exaggerated because the Claimants:

- underestimate their future R&D and E&T expenditures in the ordinary course of business;
- fail to deduct SR&ED tax credits for future additional R&D expenditures;

- fail to deduct royalty reductions for future additional R&D and E&T expenditures;
- fail to account for the benefits they will receive from conducting additional R&D and E&T; and
- fail to account for R&D or E&T that is transferrable to NL from other locations.

377. The Claimants not only exaggerate their estimated future losses, they also exaggerate the present value of those losses by misapplying the second step of the DCF method.

378. The second step discounts future cash flows to their present value through a "discount rate." The discount rate reflects the value to the Claimants of receiving compensation now instead of in the future. By receiving compensation now, the Claimants avoid the risk that compensation may be lower in future. As recognized by the Claimants' damages expert:

> [A] dollar received today has greater value than a dollar to be received in the future because there is typically some risk that the future dollar will not be received. The dollar received today, by definition, is not subject to this risk of realization.[582]

379. The Claimants' future compensation depends on their future loss. Thus, the discount rate reflects the risk that the Claimants' future loss (and, therefore, future compensation) are lower than they currently predict.

380. The risk that the Claimants' estimated future loss is lower than they currently predict is substantial. As explained above,[583] every element in that estimate is uncertain. The combined uncertainty is overwhelming. Consequently, the value to the Claimants of avoiding that risk by receiving compensation today is high. Indeed, the risk is so high that

[582] Rosen Report, ¶ 46.

[583] Counter Memorial, ¶¶ 342-370.

there may not be a discount rate that properly reflects the value of avoiding it.[584] If such a rate does exist, then it is significant.

381. The best indicators of the value to the Claimants of avoiding the risk that their predictions of the future are incorrect (and, thus, the best indicators of the discount rate) are the documents requested by Canada. Specifically, in document request 28, Canada requested documents "identifying the Claimants' annual cost of debt and cost of equity." The Claimants' cost of debt and equity reveal the market's assessment of the risk that the Claimants' predictions of the future are incorrect. Indeed, the Claimants' damages expert acknowledges that "in a damages analysis, the discount rate will be represented by a Weighted Average Cost of Capital ("WACC"), which reflects the rate of return that a business must generate in order to satisfy its equity and debt holders."[585]

382. While document request 28 requested documents which reflect that *market's* assessment of the risk that the Claimants' predictions of the future are incorrect, document requests 29 and 30 seek the *Claimants'* assessment of that risk. Those requests seek the "[e]conomic or financial analyses or assessments provided to senior management."

383. The Claimants refused to provide these documents.[586] Until the Tribunal rules on Canada's application that it order their production, it is premature to calculate the appropriate discount rate. However, publicly available information gives a rough indication of the risk that the Claimants' predictions of the future are incorrect and, therefore, of the appropriate discount rate. For example, Mobil's return on equity, which indicates the market's past assessments of risk, has ranged between 13% to 40%.[587]

[584] Walck Report, ¶ 136.

[585] Rosen Report, ¶ 49.

[586] Redfern Schedule, October 6, 2009, pp. 31-36.

[587] Walck Report, ¶ 143.

384. The discount rate applied by the Claimants is grossly inappropriate because the Claimants assume that there is no risk that their estimate of future loss is incorrect. Extraordinarily, the Claimants apply a risk-free discount rate of less than 3%.[588] As recognized by Canada's damages expert, Richard Walck, the attempt of the Claimants' expert "to suggest that the Claimants must be protected from any possible incurrence of risk serves to inflate damages ... but it completely divorces the discount rate from the risk profile inherent in the cash flows he attempts to estimate."[589]

385. Mr. Walck quotes a series of authors who reject the Claimants' approach, including a "trio of respected valuation analysts and authors" who describe such an approach as an "egregious" error.[590] Mr. Walck goes on to state:

> The error in Rosen's approach is plainly evident when viewed from the standpoint of the Respondent who is being asked to pay a sum today that supposedly represents the discounted present value of the future R&D expenditures it will receive from Claimants over the next twenty-seven years. Rosen suggests that this "investment" by Canada should be evaluated as risk free. Those future R&D expenditures, however, are anything but guaranteed.[591]

386. The Claimants assert that risk should not be incorporated into the discount rate because the Claimants will suffer future damages through future expenditures and not through reduced future profits.[592] Yet, the Claimants fail to explain why this difference shields the Claimants from the risk that their predictions of the future are incorrect. Regardless of whether their future damages are incurred through expenditures or reduced profits, there is risk that their calculation of those future damages is incorrect. The

[588] Rosen Report, ¶ 52.

[589] Walck Report, ¶ 134.

[590] **RA-40,** Shannon P. Pratt, Robert F. Reilly & Robert P. Schweihs, *Valuing a Business* (4th ed., 2000), p. 195 (Walck Report, Exhibit 12).

[591] Walck Report, ¶ 145.

[592] Rosen Report, ¶ 50.

Claimants avoid that risk by claiming their compensation as a lump sum now and must, accordingly, pay a discount.

VI. REQUEST FOR RELIEF

387. Canada requests that the Tribunal reject the claims and order that the Claimants pay the costs and legal fees of Canada incurred as a result of this arbitration.

Sylvie Tabet
Nick Gallus
Mark Luz
Adam Douglas
Pierre-Olivier Savoie
Carolyn Elliott-Magwood

On behalf of the Respondent, Government of Canada